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OCTOBER TERM, 1971

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No. 71-113

CARGILL, INCORPORATED, ERWIN E. KELM, H. ROBERT DIERCKS, WALTER B. SAUNDERS and BENJAMIN S. JAFFRAY,

Petitioners,

vs.

CLIFFORD M. HARDIN, Secretary of Agriculture, THOMAS J. FLAVIN, Judicial Officer by Appointment of the Secretary of Agriculture, and the UNITED STATES DEPARTMENT OF AGRICULTURE,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

Petitioners Cargill, Incorporated, Irwin E. Kelm, H. Robert Diercks, Walter B. Saunders, Benjamin S. Jaffray (hereinafter referred to collectively as "Cargill") pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Eighth Circuit entered on December 7, 1971.

OPINIONS BELOW

The Opinion of the Court of Appeals is reported at 452 F.2d 1154 (8th Cir. 1971) and is reprinted in Appendix A, *infra*, pp. 1-39. The Opinion of the Judicial Officer of the United States Department of Agriculture is reported at 29 Agri. Dec. 880 (CEA 1970).

JURISDICTION

The judgment sought to be reviewed was dated and entered in the United States Court of Appeals for the Eighth Circuit on December 7, 1971. The jurisdiction of this Court to review that judgment by writ of certiorari is invoked under 28 U.S.C. § 1254(1) (1970).

QUESTION PRESENTED FOR REVIEW

Whether the actions of Cargill described below constitute "manipulation" of wheat future prices on the Board of Trade of the City of Chicago within the meaning of the Commodity Exchange Act.

STATUTORY PROVISION INVOLVED

This case involves section 6(b) of the Commodity Exchange Act, 7 U.S.C. § 9 (1970). This statutory provision is set forth at Appendix B, *infra*, pp. 40-41 (Statutory Provision Involved).

STATEMENT OF CASE

Cargill petitioned the United States Court of Appeals for the Eighth Circuit to vacate or set aside an order of the Secretary of Agriculture made through the Judicial Officer of the United States Department of Agriculture (hereinafter "USDA") and entered on August 13, 1970, pursuant to section 6(b) of the Commodity Exchange Act, 7 U.S.C. § 9 (1970). *In re Cargill, Inc.*, 29 Agri. Dec. 880 (CEA 1970). The order sought to be vacated or set aside was issued after an administrative proceeding under the Commodity Exchange Act against Cargill. The Complaint charged that Cargill attempted to manipulate, and did in fact manipulate, the price of May, 1963 wheat futures on the Board of Trade of the City of Chicago on May 21, 1963, and the price of cash wheat in Chicago on May 20 and 21, 1963, in willful violation of section 6(b) of the Commodity Exchange Act, 7 U.S.C. § 9 (1970).

Cargill filed separate Answers denying any attempted or actual manipulation and requested a hearing on the Complaint. Prior to the hearing, permission was granted to the Board of Trade of the City of Chicago, the Association of Commodity Exchange Firms, Inc., and the Great Plains Wheat Market Development Association, Inc. to intervene on behalf of Cargill.

The hearing took place at intervals before a USDA referee in Minneapolis, Chicago, and Washington, D. C., and was concluded in November, 1966, after 32 trial days. The record contains 4,715 pages of oral testimony by some 50 witnesses and over 200 exhibits, many of which consist of multiple documents.

The referee issued a recommended decision (112 pages) on August 12, 1968, to the general effect that Cargill had violated the Act as charged in the Complaint and proposed

an order suspending the registration of Cargill as a futures commission merchant under the Act for a period of 90 days and an order to the contract markets to refuse all trading privileges to Cargill for a period of 90 days. The case was then referred to the Judicial Officer of USDA for review and decision.

Cargill filed exceptions to the referee's recommended decision as did the Board of Trade of the City of Chicago. The Judicial Officer adopted most of the referee's recommendations, but did not sustain the charge that Cargill manipulated the price of cash wheat in Chicago on May 20 and 21, 1963. He further held that the proposed sanctions of the referee should be suspended because of Cargill's "apparent reliance on the Circuit Court decision in *Volkart [Bros., Inc. v. Freeman*, 311 F.2d 52 (5th Cir. 1962)] as legitimatizing the conduct in issue. . . ." *In re Cargill, Inc.*, 29 Agri. Dec. 880, 915 (CEA 1970). He, nevertheless, held that Cargill manipulated the price of the May, 1963 wheat futures on the Board of Trade of the City of Chicago on May 21, 1963.

Cargill filed a timely petition to the United States Court of Appeals for the Eighth Circuit to vacate or set aside the order of the Judicial Officer. The Board of Trade of the City of Chicago and the Board of Trade of the City of Kansas City were granted permission and filed *amicus curiae* briefs supporting Cargill's position. On December 7, 1971, the Court of Appeals affirmed the Judicial Officer's decision.

REASONS CERTIORARI SHOULD BE GRANTED

The special and important reasons for granting a review on writ of certiorari in the instant case are:

I. The United States Court of Appeals for the Eighth Circuit has rendered a decision in clear conflict with a decision of the United States Court of Appeals for the Fifth

Circuit in *Volkart Bros., Inc. v. Freeman*, 311 F.2d 52 (5th Cir. 1962), on the same matter.

II. The United States Court of Appeals for the Eighth Circuit has decided an important question of federal law in the instant case which has not been, but should be, settled by this Court.

III. The United States Court of Appeals for the Eighth Circuit has decided a federal question in a way in conflict with an applicable decision of this Court.

ARGUMENT

I. The United States Court of Appeals for the Eighth Circuit Has Rendered a Decision in Clear Conflict With a Decision of the United States Court of Appeals for the Fifth Circuit in Volkart Bros., Inc. v. Freeman, 311 F.2d 52 (5th Cir. 1962), on the Same Matter.

The most efficient marketing system of major commodities the world has ever witnessed has been developed in the United States. The key to this marketing system of the major commodities is the commodities futures markets. In 1970 the dollar volume on the Board of Trade of the City of Chicago was over 73 billion dollars. Futures trading in commodities perform several economic functions including insurance through hedging and reliable pricing information. The instant case is concerned with trading in wheat futures contracts on the Board of Trade of the City of Chicago. The Eighth Circuit has described in some detail "The nature of a commodities futures market" in its Opinion. (App. pp. 2-7) This description is very helpful in understanding the instant case.

In 1936, Congress enacted the Commodity Exchange Act, 7 U.S.C. §§ 1-13 (1970), to safeguard commodity futures

trading by prohibiting price manipulation; the word "manipulate" is not defined in the statute. Through the years, a basic dispute on the meaning of "manipulate" has developed between the agency set up to administer the Commodity Exchange Act, the Commodity Exchange Authority (hereinafter "CEA") and the people who utilize and depend upon futures trading. This dispute revolves around the obligation of a short to perform a futures contract when the physical commodity necessary for delivery is not "readily available." This dispute culminated in 1961 when the Judicial Officer of USDA held in *In re Volkart Bros., Inc.*, 20 Agri. Dec. 306 (CEA 1961), *rev'd, Volkart Bros., Inc. v. Freeman*, 311 F.2d 52 (5th Cir. 1962), that while a long in general has the right to stand on his contract and demand delivery, ". . . there are circumstances such as inadequate deliverable supplies relative to his long interest in which standing for delivery to push prices up constitutes manipulation of prices in violation of the act." 20 Agri. Dec. at 340. The decision that enforcement of a futures contract when the cash commodity is not "readily available" for delivery constitutes "manipulation" under the Commodity Exchange Act rallied the entire cotton industry around the accused. The New York Cotton Exchange, the New Orleans Cotton Exchange and the American Cotton Shippers Association intervened on behalf of *Volkart* before the United States Court of Appeals for the Fifth Circuit to express their dismay in the Judicial Officer's decision which undermined the whole basis for futures trading. The intervenors and *Volkart* were successful and the Fifth Circuit reversed the Judicial Officer's decision holding:

> "The petitioners can be held to a purpose to create prices not responsive to the forces of supply and demand only upon the assumption that the shorts should not be held

> to their contract obligation to deliver the cotton. Unless the shorts are to be excused from the performance of their contracts and from the exercise of due diligence to that end, the ample supply of uncertificated cotton must be considered as available to them."

311 F.2d at 59-60.

Less than a year after the *Volkart* decision was rendered by the Fifth Circuit, a situation developed in the 1963 May wheat future on the Board of Trade of the City of Chicago involving essentially the same situation as *Volkart*. A shortage of soft red winter wheat developed throughout the country including Chicago, and Cargill, which had correctly analyzed the supply-demand situation and had anticipated such an event, held long May, 1963 wheat futures contracts on the Board of Trade of the City of Chicago of approximately 2,000,000 bushels on the last day of trading in the futures. Cargill did not liquidate this futures position until the futures price reflected what cash wheat was selling for in the Chicago area. The CEA, ignoring *Volkart*, charged Cargill with "manipulation" under the Commodity Exchange Act alleging, *inter alia*, that the failure to liquidate the futures position when a shortage of soft red winter wheat developed constituted "manipulation" under the Commodity Exchange Act because the physical commodity necessary for delivery in the futures market was not "readily available" to the shorts on the last day of trading. Recognizing that this charge, if sustained, would jeopardize futures trading, the Board of Trade of the City of Chicago, the Association of Commodity Exchange Firms, Inc., and the Great Plains Wheat Development Association, Inc. all intervened on behalf of Cargill.* Nevertheless, the Judicial Officer of USDA

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*In addition, before the Eighth Circuit, the Board of Trade of the City of Kansas City intervened and filed an *amicus curiae* brief.

held Cargill guilty of "manipulation" but suspended any proposed sanctions in part because of Cargill's reliance on *Volkart Bros., Inc. v. Freeman*, 311 F.2d 52 (5th Cir. 1962), as "legitimatizing the conduct in issue." *In re Cargill, Inc.*, 29 Agri. Dec. 880, 915 (CEA 1970).

Although all proposed penalties against Cargill were suspended, Cargill appealed the Judicial Officer's Decision to the Eighth Circuit because it feels strongly that it is absolutely essential to the continued operation of all futures commodities exchanges to establish that:

1. The interpretations by the Circuit Courts of the Commodity Exchange Act can safely be relied upon by the trade and will be adhered to by the CEA in enforcing the act;

2. The principles established by the court in *Volkart* will be followed; and

3. A definition of "manipulation" will be adopted that is universally understood and workable.

The Eighth Circuit decided not to follow *Volkart* and failed to articulate a realistic and workable definition of "manipulation." The Eighth Circuit did not ignore or attempt to distinguish the Fifth Circuit's decision in *Volkart* from this case; rather, it accepted CEA's argument that the Fifth Circuit's decision was "plainly wrong" in *Volkart*; indeed, the Eighth Circuit's decision is replete with instances where it disagrees with the Fifth Circuit's decision in *Volkart*. (App. pp. 23-24, 36-38) The Eighth Circuit concluded that *Volkart* should not be followed because its "approach disregards commercial reality and the economic functions of the futures market." (App. p. 37) It is respectfully submitted that it is the Eighth Circuit which does not understand futures trading and whose approach "disregards commercial reality and the economic functions of the futures market" and whose decision, if allowed to stand, will eventually do

immeasurable harm to futures trading and may well lead to destruction of commodity futures markets.

The situation where the physical commodity is not "readily available" for delivery in commodity futures markets is becoming more and more frequent. For example, in recent years, soybeans, oats, wheat, etc. have not been "readily available" in Chicago to shorts for delivery purposes on the final day of trading in futures contracts. If futures contracts are no longer enforceable when the physical commodity is not "readily available," people cannot afford to trade in and rely on futures markets. Thus, this Court must settle a clear conflict between the Courts of Appeals concerning a situation that is arising and will continue to arise frequently in the future, and which has enormous economic implications for the entire agricultural sector of our economy.

II. The United States Court of Appeals for the Eighth Circuit Has Decided an Important Question of Federal Law in the Instant Case Which Has Not Been, But Should Be, Settled by This Court.

The Commodity Exchange Act, 7 U.S.C. § 9 (1970), provides in part in section 6(b) that the Secretary of Agriculture may suspend or revoke trading privileges of any person who "has *manipulated* or is attempting to *manipulate* the market price of any commodity in interstate commerce or for future delivery on or subject to the rules of any board of trade." (Emphasis added) As noted above, the word "manipulate" is not defined in the statute.

As the Eighth Circuit noted in the instant case "There are no Supreme Court precedents on this question under the Commodity Exchange Act." (App. p. 24) There can be little dispute on the importance of a universally understood and workable definition of "manipulation" to the people in-

volved in the merchandising of commodities and who trade and rely on futures markets. This is evidenced by the intervenors in *Volkart* and in this case and by the witnesses who testified on behalf of Cargill below which included many distinguished members of the grain trade. Virtually every segment of the grain trade is united with Cargill on the importance of this issue and agrees with Cargill on the definition of "manipulation." It is respectfully submitted that the definition of "manipulation" adopted by the Eighth Circuit is erroneous, impractical and will lead to serious dislocations in the futures markets. As noted above, the total value of futures contracts traded on the Board of Trade of the City of Chicago in 1970 was $73 billion. More importantly, the entire world relies on the futures prices as a guide in the trading of the cash commodity. If these prices are to continue to be helpful, they must reflect the value of the cash commodity at that time, not the "average" price over a period of time. As noted above, the situation where the physical commodity is not "readily available" to shorts in commodity futures markets is becoming more and more frequent. Thus, it is readily apparent that this Court must now articulate a universally understood and workable definition of "manipulation" under the Commodity Exchange Act.

III. The United States Court of Appeals for the Eighth Circuit Has Decided a Federal Question in a Way in Conflict With an Applicable Decision of This Court.

Mr. Justice Holmes declared for this Court in *Board of Trade of the City of Chicago v. Christie Grain & Stock Co.*, 198 U.S. 236, 249 (1905), that: "The sales in the pits [futures contracts] are not pretended, but, as we have said, are meant and supposed to be binding." The position of CEA is directly opposed to the decision of this Court in *Christie*.

In the instant case CEA argued that the *Volkart* decision is plainly wrong, because it is based on the integrity of the delivery obligation and the delivery obligation is "the stuff that dreams are made of." CEA further argued that to require shorts at the maturity of each contract to make ready to deliver would greatly diminish the usefulness of futures trading. This argument, which was accepted by the Eighth Circuit, attacks the fundamental principle governing the operation of commodity futures exchanges and is in direct conflict with this Court's decision that futures contracts are "real contracts." If the Eighth Circuit's decision is allowed to stand, it will destroy the integrity of the futures market; negate the obligation of a short to deliver the commodity; deny the right of a long to require delivery; and interfere with the ability of the futures markets to properly reflect the price of the cash commodities being traded.

These are not empty words. Those who trade on a commodity exchange undertake obligations under their contracts which must be observed. The Eighth Circuit would excuse them when their obligations become burdensome. The proposition asserted by CEA and sustained by the Eighth Circuit is that a speculator may sell short on a commodity exchange; may refuse to liquidate his position as the day of performance approaches but may maintain his position to the last day; may make no privision for delivery of the commodity which is the only other way of performing his contract if he remains in the market; and require the longs to come to him and offer to offset his contracts on the exchange at an "average" price apparently to be determined later by running useless formulae through a computer—rather than the price which reflects the price of the cash commodity. The failure of the longs to offset at such an "average" price constitutes manipulation says the Eighth Circuit. That is why this case is so

important not only to Cargill but to all the people utilizing the futures markets.

A contract on a futures exchange may be performed either by offset on the exchange or by delivery and receipt of warehouse receipts for the physical commodity. To be sure, most contracts are performed by offset. However, despite this fact, it is well settled that a commodity exchange which did not require a short to deliver at maturity and a long to receive the commodity at maturity would be a gambling institution. The legality of every futures exchange rests on the obligation of the parties to the futures contract to deliver or take delivery of the commodity unless the contract has been liquidated by offset on the exchange.

> "The exchange contract provides for delivery or acceptance of delivery and neither broker nor customer has any choice in the matter. It is as certain as anything can be that a party who buys or sells a futures contract and does not offset it by a contra transaction will receive the commodity or be called upon to deliver."

Baer and Saxon, *Commodity Exchanges and Futures Trading*, p. 305 (1949).

The fundamental principle underlying all commodity exchanges is that a person who buys or sells a futures contract and does not offset it by a contra-transaction on the exchange must receive the commodity or be called upon to deliver it. The fact that most persons who trade on a commodity exchange expect to offset their contracts before the date of delivery or receipt is not a denial of this principle. *Board of Trade of the City of Chicago v. Christie Grain & Stock Co.*, 198 U.S. 236, 249 (1905). We respectfully submit that this Court must again reaffirm its decision that a futures contract is a real contract, not a pretended contract, and not "the stuff that dreams are made of."

CONCLUSION

The outcome of this case is of vital importance not only to the grain industry but to all industries marketing commodities and utilizing futures exchanges. The Commodity Exchange Act was enacted in 1936. This case is clear evidence of the confusion which the CEA has developed on the meaning of the word "manipulation." The Fifth Circuit and the Eighth Circuit have rendered decisions in clear conflict on the same matter. The instant case is inconsistent with another decision of this Court and presents an important question of federal law which must be settled by this Court so that the most efficient marketing system of major commodities the world has ever witnessed can be preserved.

Respectfully submitted,

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APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No. 20,597

Cargill, Incorporated, Erwin E. Kelm, H. Robert Diercks, Walter B. Saunders and Benjamin S. Jaffray,

Petitioners,

vs.

Clifford M. Hardin, Secretary of Agriculture, Thomas J. Flavin, Judicial Officer by Appointment of the Secretary of Agriculture, and the United States Department of Agriculture,

Respondents.

Appeal from an Order of the United States Secretary of Agriculture.

December 7, 1971.

Before JOHNSEN, Senior Circuit Judge, GIBSON and LAY, Circuit Judges.

GIBSON, Circuit Judge.

This is a petition to set aside an order of the Secretary of Agriculture entered August 13, 1970, finding that the petitioners, Cargill, Inc., and four of its officers (hereafter collectively referred to as Cargill) had manipulated the

market price of May 1963 wheat futures[1] on the Chicago Board of Trade in violation of the Commodity Exchange Act, 7 U.S.C. §§ 9 and 13. Proposed sanctions were suspended because of the undue protraction of the proceedings, not due to any fault of the petitioners, and because of their apparent reliance on the case of *Volkart Bros. v. Freeman*, 311 F.2d 52 (5th Cir. 1962), as legitimating the conduct in question.

I. THE NATURE OF A COMMODITIES FUTURE MARKET

In order to understand the nature of this case, a brief description of the operation of a commodity futures market is necessary. Trading in commodities futures is regulated by the Secretary of Agriculture pursuant to the provisions of the Commodities Exchange Act, 7 U.S.C. §§ 1 et seq., and must be conducted only on a designated contract market in accordance with the market rules. The Chicago Board of Trade is a designated contract market, and the parties are in basic agreement with the following description of wheat futures trading on the Chicago Board of Trade during the times in question.

Chicago is the major futures market for wheat, particularly soft red winter wheat. A wheat futures contract on the Chicago Board of Trade is a contract made on or subject to the rules of the Board of Trade, in which one party agrees to sell and deliver and the other party agrees to buy and receive a specified quantity of wheat at a speci-

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[1]Cargill was also charged with cornering or manipulating the cash market on wheat in Chicago on May 20 and 21, 1963 and the hearing referee so found; but this charge was not sustained by the Judicial Officer, acting on behalf of the Secretary of Agriculture.

fied price in a designated month in the future. The normal trading unit is one contract consisting of 5000 bushels. The parties determine the price, the number of contracts or quantity of wheat, and the month of delivery. All other items and conditions of the contract are fixed by the rules of the Board of Trade and are incorporated into every contract. When the proper deposits are made, the clearing organization of the Board of Trade is substituted as buyer from the seller and as seller to the buyer and thereafter each of the contracting parties is obligated only to the clearing organization.

A wheat futures contract must be satisfied or liquidated by (1) an opposite and offsetting transaction in the same future prior to the expiration of trading in that future, or by (2) delivery of the specified quantity of wheat by the seller and its receipt and payment by the buyer during the specified delivery month and in conformity with the rules of the Board of Trade.[2] A trader who fails to satisfy one or the other of these conditions is in default on his contract.

A trader who has bought futures and is therefore obligated to take delivery or make an offsetting sale has an open long position and is referred to as a "long," and a trader who has sold futures and is obligated to deliver or make an offsetting purchase is a "short" and has an open short position. The maximum net long or net short speen-

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[2]As a matter of reality and practice rarely does a future commodity dealer actually intend to take or make delivery on that commodity. Commentators estimate it to be less than 1 per cent.

Even persons engaged in genuine hedging operations generally do not intend to make or take delivery. Belveal, *Charting Commodity Market Price Behavior* (1969), p. 156; Working, "Economic Functions of Futures Markets," in *Futures Trading in Livestock* (1970), p. 20; Merrill Lynch, Pierce, Fenner & Smith, *The Hedger's Handbook* (1970), p. 7.

lative position in any wheat future which any one person may hold or control on any one contract market is 2,000,000 bushels.

The crop year for wheat in the United States is from approximately June 1 to May 31 of the following year. At all times material herein the delivery months in which wheat futures could be traded on the Chicago Board of Trade were July, September, December, March and May. The May 1963 wheat future was the last future for the 1962-1963 crop year (old crop), and the July 1963 wheat future was the first future for the 1963-1964 crop year (new crop). June 1, 1962, was the first day for trading in the May 1963 future and May 21, 1963 (Tuesday) was the last day. During the remaining seven business days in May, deliveries of wheat in satisfaction of May 1963 futures contracts could be made. May 31, 1963 (Friday) was the last day for delivery of wheat in satisfaction of a May 1963 futures contract. Any May 1963 futures contract open thereafter was in default.

Approximately 99 per cent of futures contracts on the Chicago Board of Trade are offset by an opposite transaction or transactions. When a futures contract is satisfied by delivery, the delivery is effectuated by tender on the part of the seller and acceptance on the part of the buyer of a warehouse receipt or receipts covering a specified quantity of deliverable grade wheat stored in a designated warehouse in the Chicago area approved by the Chicago Board of Trade as regular for delivery. There are no delivery points outside of the Chicago area. Under the rules of the Board of Trade, during the last three business days of a delivery month delivery may also be made by tendering deliverable grade wheat loaded in railroad cars on track in the Chicago switching district, which cars are consigned to an approved Chicago warehouse or elevator.

Soft red winter wheat is one of various classes of wheat produced in the United States, and Chicago is one of the principal markets for such wheat. The Chicago wheat futures contract is essentially a soft red winter wheat contract because No. 2 soft red winter wheat is the cheapest grade and class deliverable at par in satisfaction of the contract, and therefore the price of the Chicago wheat future tends generally to reflect the value of No. 2 soft red winter wheat.

If the futures market is functioning properly, at the close of trading in the future, the price of the future will correspond closely to the price of the cash wheat which will satisfy delivery. Thus, if in the interim between the making of the futures contract and the close of trading in the future, the price of wheat declines (which decline will be reflected in the decline of the price of the future), then the short will have made a profit on his contract, because he can either buy the wheat at the lower price in the cash market and deliver it for the higher price in his futures contract, or he can offset his short contract in the futures market by buying futures at the lower price. Conversely, if the price of wheat rises, (which will cause the price of the future to rise), the long will have made a profit on his contract, because he can take delivery of the cash wheat at the lower price in his futures contract and sell it at the higher market prices, or he can offset his long contract in the futures market by selling at the higher price.

As the Chicago Board of Trade points out in its *amicus curiae* brief in this case, futures trading in commodities performs several economic functions. The seasonal nature of crop production created the necessity for a mechanism whereby farmers could spread the sale of their crops over many months. Futures contracts, which allow the agricultural

producer to sell his crop for delivery in a future month helps to eliminate the fluctuation of crop prices which results from the imbalance of supply over demand at the end of a harvesting period.

In addition, futures trading in commodities on a large, well-organized exchange provides reliable pricing information for persons and firms throughout the world who buy and sell the commodity on the cash market for consumption, processing or resale. Price quotations for commodities traded on the Board of Trade for future delivery are disseminated around the world and are used by those who trade in the cash commodity as guidelines in their pricing of the commodities.

Finally, since a futures contract permits the immediate fixing of the price of a transaction that will not be consummated until a future date, futures trading performs an "insurance" function. For the seller of agricultural products confronted with the risk of price decline prior to sale, and for the buyer of those products confronted with the risk of price increase prior to purchase, the futures market offers a form of "price insurance" which guarantees the futures price agreed to even if market prices subsequently rise or fall prior to the date of delivery. Persons utilizing the futures market as protection from the risk of adverse price fluctuations are commonly called "hedgers", and the use of futures contracts for this purpose is called "hedging." A grain merchant will usually sell short or hedge its stock of cash wheat in a futures market. The hedge acts as an insurance against drastic drops in the price of wheat. Processors of wheat will normally hedge their mill commitments by buying long futures. The long futures act as insurance against a rapid rise in the price and can be utilized as a source of supply for the processors. In general, hedging

transfers the risk of price changes to the holders of futures.

The avoidance of this risk by "hedgers" necessarily means that other persons must be willing to take that risk. These other persons, commonly called "speculators," invest in commodity futures contracts for capital appreciation. Speculation supplies needed risk capital, increases the volume of trade to allow easy market entry and egress, and keeps the various markets in alignment through inter-market trading operations.

In order for the futures market to perform its functions effectively, prices must reflect as nearly as possible market factors of supply and demand. Manipulation of prices by means not reflecting basic supply and demand factors creates conditions which prevent the futures market from performing its basic economic function and hence diminishes its utility to those members of the trade and general public who rely on its basic purposes. For this reason, price manipulation is forbidden by the Commodity Exchange Act, 7 U.S.C. §§ 9 and 13. It is price manipulation with which Cargill is charged in this proceeding.

II. CARGILL'S ACTIVITIES IN THE MAY 1963 CHICAGO WHEAT FUTURES MARKET

Cargill, Inc., is a closely held family corporation and is one of the largest grain merchandisers and exporters in the country. It owns an elevator and warehouse in Chicago which is designated regular for delivery of grain on the Chicago Board of Trade. In early 1963, Cargill was of the opinion that there would be an ample supply of soft red winter wheat at the end of the crop year, May, 1963, and hence hedged its inventory by selling May 1963 wheat futures on the Chicago Board of Trade. In early March 1963 it reached a maximum short position in the future of more than eight

million bushels.[3] As explained above, such a hedge operates as "insurance" against falling prices.

However, in February and March of 1963, Cargill sold substantial quantities of soft red winter wheat to mills in the Southwestern part of the United States. This demand was unusual because ordinarily soft red winter wheat does not move from Chicago to the Southwest. Apparently the movement was prompted by an unusual combination of freight rates which made it economical to ship wheat in this direction. Also in March, the Spanish Government indicated a definite interest in purchasing large quantities of soft red winter wheat and Cargill hoped that it would be able to obtain some of this business. Based upon these developments, Cargill revised its opinion of the supply-demand situation and concluded that supplies of wheat would be tight by May, the end of the crop year, that therefore prices would not fall, but might rise, and began liquidating its short hedges and established a long position in March 1963 Chicago futures.

On April 15, 1963, Cargill liquidated all of its short hedges remaining in the May future and established a long speculative position of 250,000 bushels.[4] Between that date and May 15, Cargill increased its speculative long position to 1,930,000 bushels.

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[3]The position limits referred to above of two million bushels apply only to speculative positions. Since Cargill's position at this point was a bona fide hedge, its holding of eight million bushels did not violate the position limits. Chicago has a total elevator capacity of around 70,000,000 bushels, of which Cargill owns and operates 22,000,000 bushels.

[4]There is no controversy between the parties that Cargill's position was speculative. There are situations of course in which a grain merchandiser's long futures position might be hedging, such as where he has made sales of cash wheat which he does not have sufficient supplies on hand to fulfill; in such a case he might purchase futures in order to assure himself of supplies to meet his commitments. However, at the time Cargill established its long futures position it had ample supplies of uncommitted wheat stocks, and thus its position was speculative.

The United States Department of Agriculture publishes figures every week indicating the quantities of deliverable grade wheat located at various market areas around the country; these figures do not indicate the ownership of such supplies. On April 12, 1963, just prior to the date Cargill established its long position in the May 1963 wheat future, Department figures showed that there were 2,804,000 bushels of deliverable grade wheat stored in Chicago warehouses. Of this amount; Cargill owned 2,471,000 bushels. It is important to note here that Cargill was thus in possession of a vital piece of information that other traders and grain dealers in Chicago did not have access to, namely that it owned the bulk of deliverable wheat in Chicago. While all traders of course knew the total quantity of deliverable wheat available in Chicago, only Cargill was in a position to know that it owned the vast majority of this wheat.

In early May 1963 it became known that the Spanish Government would in fact purchase large quantities of wheat; and on Saturday, May 11, it offered to purchase 50,000 tons (40 bushel to the ton) of soft red winter wheat to be delivered by June 10. At this point in time, no American exporter could make this sale because the Department of Agriculture subsidy cutoff date for export of old crop wheat was May 31, and logistical considerations prevented the loading and shipping of the wheat in time to meet the subsidy deadline.[5] Cargill so informed the Department of Agriculture. On Monday, May 13, the Department of Agriculture announced that the subsidy deadline had been extended to June 10, 1963.

On Tuesday, May 14, 1963, Cargill offered to sell to Spain 12,500 tons of wheat at a price which equaled $2.13½ per

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[5]United States exporters cannot meet world price competition in wheat without the benefit of government export subsidies.

bushel or 10½ cents over the May future; and on the next day, Cargill offered 15,000 tons at a price which equaled $2.69 per bushel or 5½ cents over the May future. Both of these offers were accepted on Saturday, May 18. Cargill thereupon loaded out 770,000 bushels of wheat from its Chicago elevator and shipped it to Spain. Cargill made a profit on both of these Spanish sales.

This loadout together with other commitments left Cargill with approximately 50,000 bushels of wheat in its warehouse as of Monday afternoon, May 20. This constituted all of the wheat in Chicago warehouses which was available for delivery on the May wheat future.[6]

Monday, May 20, and Tuesday, May 21, were the last two days in which the May 1963 wheat future could be traded on the Chicago Board of Trade, and Cargill decided that it was time to begin liquidating its long futures position. Under Board of Trade rules, the maximum permissible price fluctuation of wheat futures is 10 cents above or below the previous day's closing price. The maximum permissible high price Monday was $2.19⅜. Cargill placed an order with its broker to sell 100,000 bushels of futures at $2.19. The broker was able to sell only 40,000 bushels at this price and the order was canceled. The market closed that day at $2.18⅝, an increase of 9¾ cents from the previous day's closing price.

At the opening of business on May 21, 1963, there was a total open interest in the May 1963 wheat future of approximately 8 million bushels. Of this, Cargill owned 1,890,000 bushels or about 24 per cent. At the same time the quantity

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[6]There apparently were a few other much smaller stocks located in Chicago warehouses. These stocks, however, were all owned by grain mills which needed them for their own grind requirements, and hence they were not available for delivery.

Actually as of May 16, 1963 all of Cargill's soft red winter wheat located in Chicago was committed on offers and sales.

of deliverable wheat in Chicago warehouses owned by persons other than Cargill was approximately 20,000 bushels. When trading opened at 9:30 a.m., the future traded at approximately $2.22 and gradually declined until at 11:02 a.m. it traded at $2.15¼ which was the low price for the day. During this period, Cargill purchased another 100,000 bushels of futures which increased its speculative long position to 1,990,000 bushels. Additionally, Cargill obtained control of another 50,000 bushels which it agreed to sell for Continental Grain Company's account. Trading in the future was to cease at 12:00 p.m.

At 11:45 the future was trading at $2.20. At this point Cargill transmitted to its broker six orders to sell its futures position as follows:

200,000 bushels at $2.27
200,000 bushels at $2.27¼
300,000 bushels at $2.27½
400,000 bushels at $2.27¾
500,000 bushels at $2.28
390,000 bushels at $2.28¼

These orders were limit orders, which meant that the sales could not be made below the prices specified. The maximum price at which the May 1963 future could be sold was $2.28⅝.

Prices did not reach the limits specified in Cargill's order until 11:53 a.m. At this time Cargill's holdings constituted approximately 62 per cent of the open interest. From this time until the close of trading, Cargill's broker liquidated 1,625,000 bushels for Cargill's account. Prices reached $2.28⅝, the limit for the day. Confusion and congestion was so great at the close of trading that 420,000 bushels remained open after trading ended, and Cargill had unliquidated holdings of 365,000 bushels.

Shortly after the close of trading, Cargill was visited by the Acting Chairman of the Business Conduct Committee of the Chicago Board of Trade, who requested Cargill's cooperation in the orderly liquidation of its remaining long position, pointed out the apparent short supply of soft red winter wheat in the Chicago area and suggested that Cargill offer to sell warehouse receipts to the unresolved shorts in order to clear up the May wheat future. Cargill replied that it only had approximately 35,000 bushels of uncommitted wheat available for sale, but that it could make substantially greater amounts of warehouse receipts available at a price of $2.28¼ if it could be assured of receiving these receipts back in settlement of its long position, since this wheat was actually needed for delivery on prior commitments. There were at this time no other warehouse receipts available in Chicago for delivery on the May wheat future. Cargill was advised by the Chicago Board of Trade that it would receive its receipts back in the course of delivery.

Cargill thereupon sold 109,000 bushels of warehouse receipts to various commission houses for $2.28¼ per bushel. (Approximately 75,000 bushels of this wheat was already committed under prior sales.) These receipts were then tendered to Cargill in satisfaction of the shorts' delivery obligations, resold by Cargill and then redelivered to Cargill and other longs in satisfaction of the contracts, and this process was continued until 370,000 bushels of the unresolved open interest were liquidated by this method. In the course of this circulation, 55,000 bushels of Cargill warehouse receipts were received by longs other than Cargill, who then sold these receipts to other unresolved shorts, who in turn redelivered them to Cargill. Cargill liquidated 315,000 bushels of its long futures by this method, and in addition received 50,000 bushels of wheat from other sources.

To summarize then the liquidation of the 420,000 bushels open interest remaining after the close of trading in the May 1963 wheat future, Cargill received 315,000 bushels of its own warehouse receipts plus 50,000 bushels of wheat from other sources, while other longs received 55,000 bushels of Cargill warehouse receipts. All of the Cargill receipts used in this delivery process were sold by Cargill at a price of $2.28¼ per bushel.

After settlement of the outstanding May futures contracts, Cargill had approximately 88,000 bushels of old crop wheat remaining in its warehouse. Between June 4 and June 13, it disposed of this wheat at prices ranging from $2.10 to $2.13 per bushel.

III. THE GOVERNMENT'S THEORY OF THE CASE

The above statement of the case represents essentially uncontested facts. Issues of fact and law which remain in the case are vigorously contested by the parties. In order to understand the basis of this dispute, it will be helpful to first outline the basic theory of the Government's case that Cargill manipulated the price of the May 1963 wheat futures.

The Government's theory of this case is that Cargill manipulated the price of the May 1963 wheat future by means of a device known as a "little corner" or "squeeze."[7] For purposes of clarity in the discussion, we shall use the term "squeeze" exclusively. The Government contends that the squeeze is a "well-known manipulative device" and is a type of manipulation prohibited by the Commodity Exchange Act.

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[7]Most commentators refer to a dominant position in the cash or spot market as a corner, while such position in the futures market is denoted as a squeeze. See 73 Yale L. J. 171 (1963).

Although a squeeze is defined in slightly varying fashion by different authorities, the essential elements seem to be commonly recognized. A good starting point for a definition is that given by Senator Pope when he was in charge of the bill which was enacted as the Commodity Exchange Act:

> "Squeeze (congestion): These are terms used to designate a condition in maturing futures where sellers (hedgers or speculators), having waited too long to close their trades, find there are no new sellers from whom they can buy, deliverable stocks are low, and it is too late to procure the actual commodity elsewhere to settle by delivery. Under such circumstances and though the market is not cornered in the ordinary sense, traders who are long hold out for an arbitrary price." 80 Cong. Rec. 8089.

This legislative history suggests that indeed squeezes were intended to be prohibited where they were intentionally manipulated. As Senator Pope's definition suggests, a squeeze is to be distinguished from a corner and differs from it in certain respects. In its most extreme form, a corner amounts to nearly a monopoly of a cash commodity, coupled with the ownership of long futures contracts in excess of the amount of that commodity, so that shorts — who because of the monopoly cannot obtain the cash commodity to deliver on their contracts—are forced to offset their contract with the long at a price which he dictates, which of course is as high as he can prudently make it.[8]

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[8]One of the most spectacular reported cases illustrating such a corner is *Peto v. Howell*, 101 F.2d 355 (7th Cir. 1938). It was there alleged, and the court found that the evidence substantiated the allegations, that the defendant acquired long futures in corn in the amount of 8,500,000 bushels to be delivered in Chicago; that approximately 7,000,000 bushels were delivered to the defendant in satisfaction of these contracts, which constituted 97 per cent of the deliverable supply in Chicago and 90 per cent of the deliverable supply in the whole country; that there remained 1,500,000 bushels of futures which could therefore not be satisfied by delivery; and that the defendant was therefore able to dictate an arbitrarily high price in settlement of these contracts.

Not all corners of course are so massive or so successful.

A squeeze is a less extreme situation than a corner. In this case, there may not be an actual monopoly of the cash commodity itself, but for one reason or another deliverable supplies of the commodity in the delivery month are low, while the open interest on the futures market is considerably in excess of the deliverable supplies. Hence, as a practical matter, most of the shorts cannot satisfy their contracts by delivery of the commodity, and therefore must bid against each other and force the price of the future up in order to offset their contracts. Many squeezes do not involve intentional manipulation of futures prices, but are caused by various natural market forces, such as unusual weather conditions which have caused abnormally low crop production or inadvertent destruction of a substantial volume of the commodity itself. However, given a shortage of deliverable supplies for whatever reason, the futures price can be manipulated by an intentional squeeze where a long acquires contracts substantially in excess of the deliverable supply and so dominates the futures market—i.e. has substantial control of the major portion of the contracts—that he can force the shorts to pay his dictated and artificially high prices in order settle their contracts.

The Government contends that Cargill manipulated the market price of the May 1963 wheat futures by means of a squeeze: (1) Cargill acquired and held a controlling long position in the May 1963 wheat future; (2) there was an insufficient supply of wheat available to the shorts for delivery on the futures, and what supply there was was controlled by Cargill; (3) Cargill exacted an artificially high price in liquidation of its futures contracts; and (4) the squeeze was intentionally caused by Cargill.

Cargill, on the other hand, vigorously contests the factual issues which underly each of the above contentions, and in

addition offers two defenses which counter the basic theory of the Government. First, it contends that in order to be guilty of manipulation under the Act, a trader must commit an "uneconomic act", and secondly, and more fundamentally it contends that squeezes are not a form of manipulation prohibited by the Act. We will deal with this latter contention after we have examined the Government's case for the proposition that Cargill in fact accomplished a squeeze.

While Cargill has not specifically defined what it means by an "uneconomic act", the apparent implication of its argument is an act which does not make a profit for the party involved. Since it is conceded that all of the acts done by Cargill in the instant case resulted in a profit to the company, it therefore follows from this definition that it has not been guilty of manipulation. This is a rather novel proposition, and we suspect many market traders might be startled to learn that the only manipulators among them are those who failed to make a profit on all of their various maneuvers. Cargill admits there is no case authority for this proposition and suggests it is because it has not been urged before a court in prior cases. It has now been urged and we reject it.

The Commodity Exchange Act itself does not define "manipulation", and definitions from other sources are of a most general nature. One of the few judicial definitions is to be found in *General Foods Corporation v. Brannan*, 170 F.2d 220, 231 (7th Cir. 1948), where the court said:

> "We are favored with numerous definitions of the word 'manipulation.' Perhaps as good as any is one of the definitions which appears in the government's brief, wherein it is defined as 'the creation of an artificial price by planned action, whether by one man or a group of men.'"

In the antitrust context, the Supreme Court has said:

> "* * * [M]arket manipulation in its various manifestations is implicitly an artificial stimulus applied to (or at times a brake on) market prices, a force which distorts those prices, a factor which prevents the determination of those prices by free competition alone." *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 223 (1940).

We think the test of manipulation must largely be a practical one if the purposes of the Commodity Exchange Act are to be accomplished. The methods and techniques of manipulation are limited only by the ingenuity of man. The aim must be therefore to discover whether conduct has been intentionally engaged in which has resulted in a price which does not reflect basic forces of supply and demand. In such an inquiry, the question of whether an alleged manipulator has made a profit is largely irrelevant, for the economic harm done by manipulation is just as great whether there has been a profit or a loss in the operation. In the few reported cases where a trader has been found guilty of price manipulation under the Commodity Exchange Act, the available facts indicate that the manipulators reaped handsome profits. In the case of *G. H. Miller & Co. v. United States*, 260 F.2d 286 (7th Cir. 1958), *cert. denied*, 358 U.S. 907 (1959), the manipulators profited in the sum of $162,695.15. Although no figures are given in the case of *Great Western Food Distributors, Inc. v. Brannan*, 201 F.2d 476 (7th Cir.), *cert. denied*, 345 U.S. 997 (1953), the case clearly indicates that the manipulating parties made profits in their transactions there. And it may be pointed out that one of the most common manipulative devices, the floating of false rumors which affect futures prices, does not involve the commission of an "uneconomic act." Thus we must reject Cargill's contention that manipulation under the Commodity Exchange Act must include the commission of an "uneconomic act."

IV. THE ELEMENTS OF THE SQUEEZE IN THE INSTANT CASE

We turn now to an analysis of the factual basis of the Government's case against Cargill. As to the factual findings made in the administrative proceedings, the Commodity Exchange Act directs that "the findings of the Secretary of Agriculture as to the facts, if supported by the weight of the evidence, shall * * * be conclusive." Cargill urges that this test is considerably more stringent than the "substantial evidence" test ordinarily applied to review of administrative agency findings. We think the Seventh Circuit adequately described the judicial function in these cases as being "to review the record with the purpose of determining whether the finder of the fact was justified, i.e: acted reasonably, in concluding that the evidence, including the demeanor of the witnesses, the reasonable inferences drawn therefrom and other pertinent circumstances, supported his findings." *Great Western Food Distributors, Inc. v. Brannan*, 201 F.2d 479-480. With this standard in mind, we examine the individual elements of the squeeze which the Government contends constituted the manipulation in the instant case.

A. *Did Cargill hold a dominant long position in the future?*

The first question to be confronted is whether Cargill held a controlling long position in the future. It is evident that a squeeze cannot be successfully executed unless a long has sufficient control of enough futures contracts to force the shorts to come to him to settle their contracts.

The Government's case in this aspect lies primarily in the undisputed fact that Cargill held its maximum long position of nearly 2,000,000 bushels until the last fifteen min-

utes of trading in the future, at which point it controlled 62 per cent of the long interest. On its face, ownership of 62 per cent of the open contracts would appear to be a dominant interest.

Cargill, however, argues that the Government's contention is invalid because its emphasis on Cargill's position during the last fifteen minutes of trading is improper. Applying a "reductio ad absurdum" test to the Government's argument, Cargill points out that:

> "Everyone agrees that the last long in the market in any expiring future will have 100% of the long open interest just as the last short will have 100% of the short open interest. * * * If the contentions of the CEA here were to be sustained, a 'dominant' and controlling long position and a 'dominant' and controlling short position could be found the last day of trading in every commodity future and every delivery month."

To this argument, there appear to be two answers.

In the first place, the basic question is whether the long controls a sufficient number of contracts to enable him to affect the market sufficiently so as to exact an arbitrary price for his contracts. Situations may well be imagined where the last long in the market during the last few seconds of trading simply does not have sufficient leverage to affect the price. But in the instant case, it appears to us that Cargill's control of 2,000,000 bushels of futures, constituting 62 per cent of the long interest, with 15 minutes of trading remaining, represents a sufficiently controlling position to warrant consideration of the question whether Cargill actually manipulated prices during this period.

Secondly, even conceding the most extreme result argued by Cargill, namely that under the Government's analysis the last long in the market would be a dominant long even though he had only a single contract for 5000 bushels, it is

difficult to see where this helps Cargill. For the establishment of a dominant long holding is only one aspect of the Government's case; it still must show that the dominant long exacted an artificial price in settlement of his contract. And if this single dominant long does in fact exact an artificial price for his single contract—and the Government can prove it—this would constitute price manipulation in violation of the Act.

Thus we conclude that the finding that Cargill acquired a dominant long position is supported by the weight of the evidence.

B. *Was there an insufficient supply of wheat available from sources other than Cargill for delivery on the May future?*

The next essential element of the Government's case is to establish that there were not adequate supplies of wheat other than those controlled by Cargill from which the shorts could fulfill their delivery requirements on the future. Obviously, if there were adequate supplies of deliverable grade wheat available to the shorts to deliver to the longs on the future, Cargill would not be able to exact artificial prices in settlement of its contracts, for rather than paying those prices, shorts would instead procure the wheat and deliver it.

In order to properly determine what supplies of wheat should be included in those available for delivery on the future, it is necessary to keep in mind the delivery rules of the Chicago Board of Trade. In order to be acceptable for delivery on the future, wheat had to be stored in warehouses located within the Chicago area which were designated regular for delivery by the Chicago Board of Trade, or during the last three days of the delivery month be on track in the

Chicago switching district consigned to a designated warehouse. There were no acceptable delivery points outside the Chicago area. No. 2 soft red winter wheat was the standard grade of wheat which was acceptable in fulfillment of the contract. Hard wheat could also be delivered on the contract without penalty, but the evidence clearly shows that hard wheat was a more expensive grade of wheat and no premium was allowed to the shorts for delivering this grade.[9]

The evidence as to the availability of these supplies is as follows. It is indisputable that Cargill owned practically all of the available wheat stored in Chicago warehouses. It is also clear that there were practically no supplies of No. 2 soft red winter wheat located within shipping distance of Chicago by the close of trading in the future.[10] However, it appears that there were ample supplies of hard wheat in surrounding areas which could have been shipped to Chicago in time for delivery on the future. Thus the controversy between the parties resolves itself into the question of whether this hard wheat should be considered part of the deliverable supply in determining whether there were stocks available from sources other than Cargill.

We conclude that the hard wheat stocks were properly excluded from the available deliverable supply. Case authority under the Commodity Exchange Act which would aid in

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[9]It might be pointed out that many of the problems in this case might well be eliminated if Board of Trade rules were changed to allow a premium for delivery of hard wheat.

[10]Cargill strenuously urges on this review that there were ample supplies of wheat available for delivery on the future that could have been shipped into Chicago, while conceding there were insufficient supplies in Chicago itself. It is somewhat unclear whether Cargill is contending that these outside supplies included both No. 2 soft red winter wheat as well as hard wheat or has admitted that these supplies were limited to hard wheat. However, the evidence is nearly conclusive, including testimony from Cargill's own witnesses and officers, that these supplies were limited to hard wheat.

the determination of this question is meager indeed, and the two cases available appear to have split on the question. In *Great Western Food Distributors, Inc. v. Brannan*, 201 F.2d 476 (7th Cir. 1953), the Seventh Circuit considered the problem of what supplies should be considered to be available in a corner of the egg market. The three possible sources for delivery on the future were fresh eggs, local refrigerator eggs, and out-of-town eggs. Local refrigerator eggs were the standard deliverable grade on the future. Fresh eggs could be delivered, but their price was higher and no premium was allowed to the short for their delivery. Out-of-town eggs could not be delivered after the close of trading in the future, and even prior to the close of trading, they were not ordinarily delivered because the cost of shipment and added equalizing charge made them more expensive than local refrigerator eggs. The Seventh Circuit therefore concluded that fresh eggs and out-of-town refrigerators should be excluded from the economically available supply.

Applying this precedent to our case, we would conclude that out-of-town hard wheat should be excluded from the available supply. Hard wheat was of a higher grade than No. 2 soft red winter wheat, its price was higher, no premium was allowed for its delivery, and the cost of shipment into Chicago for delivery on the future was an additional economic impediment to its delivery. It would be more economic to pay the long a premium than to pay the additional charges for premium wheat plus shipping and handling charges.

In apparent conflict with the Seventh Circuit is the Fifth Circuit's decision in *Volkart Brothers, Inc. v. Freeman*, 311 F.2d 52 (5th Cir. 1962). The Fifth Circuit was considering an alleged manipulative squeeze in the cotton futures market and dealt with the question of what should be considered

the available supply of cotton for delivery on the future. There the problem was whether uncertificated, as well as certificated cotton should be considered to be part of the available supply. Certificated cotton only was acceptable for delivery on the future and it was conceded that as of the close of trading in the future, uncertificated cotton could not be certified in time for delivery on the future. Thus the Government contended that it should be excluded from the available supply. The Fifth Circuit disagreed, noting that prior to the close of trading the shorts could have procured the cotton and placed it in the process of certification in time for delivery on the future, and that therefore it should be included in the available supply.

The Fifth Circuit reached this conclusion without any economic analysis whatsoever and did not discuss its apparent discrepancy with the *Great Western* case. Rather it argued that the Government's position simply released the shorts from their delivery obligation in their contract and would result in the futures exchanges becoming gambling enterprises. The Fifth Circuit's decision must be read as holding that squeezes are not a form of manipulation which is prohibited by the Commodity Exchange Act. Regardless of whether one agrees with this theoretical result, the *Volkart* case cannot be considered as helpful in determining whether the actual economic facts of a squeeze are present in an individual case, for the court did not discuss this problem. We consider later in this opinion whether the *Volkart* decision that manipulative squeezes should not be regulated is sound, but for purposes of the instant problem in determining what were the available supplies for delivery on the future we do not consider it to be economically realistic. The shorts could usually acquire at considerable extra cost and expense the physical commodity but settle with the longs at an arti-

ficially higher price as the lesser of two evils. This would not prevent excessive speculation "causing sudden or unreasonable fluctuations or unwarranted changes" in price condemned in 7 U.S.C. § 6(a).

There are no Supreme Court precedents on this question under the Commodity Exchange Act. However, in the closely related area of antitrust regulation under the Sherman Act, the Court has given us a test of what products should be considered to be part of the market—i.e. Supply—when determining the existence of monopoly power.

> "The 'market' which one must study to determine when a producer has monopoly power will vary with the part of commerce under consideration. The tests are constant. That market is composed of products that have reasonable interchangeability for the purposes for which they are produced—price, use and qualities considered." *United States v. Du Pont & Co.*, 351 U.S. 377, 404 (1956).

Applying that test to the Chicago wheat futures market, we do not think that hard wheat should be included in the supply. The evidence shows that soft red winter wheat is grown mainly in the farm areas surrounding the Chicago market and it is consumed chiefly in that area. It is a deliverable grade wheat at par only on the Chicago Board of Trade in contrast to other contract markets, it is the grade which is generally reflected in the wheat futures price and which is ordinarily delivered in satisfaction of the futures contract. Hard wheat is of a higher quality and price than soft red winter wheat, is rarely delivered on the contract, and no premium is allowed if it is.

It may be pointed out also that the Chicago Board of Trade also apparently did not consider out-of-town hard wheat to be available for delivery on the futures contract, for otherwise it would not have been necessary for them to

set up the rather unusual liquidation procedure described above in closing out the remaining open interest following the close of trading in the future. The fact that Cargill warehouse receipts were recirculated many times in order to close out 370,000 bushels of total 420,000 bushels open interest is itself suggestive of what the available supplies were for delivery on the future.

Thus we conclude the finding that hard wheat should be excluded from the available supply was in accord with the weight of the evidence. Since there was no soft red winter wheat available in significant quantities from sources other than Cargill, the conclusion is inescapable that the shorts could not fulfill their contracts, at least to the extent of 2,000,000 bushels, without coming to Cargill for either the offsetting contracts or the warehouse receipts.

C. Did Cargill exact an artificially high price in settlement of its long futures contracts?

This is the crucial element of the Government's case and the most hotly disputed issue before us. For if, despite the fact that it had the power and opportunity to do so, Cargill did not in fact cause an artificial price it cannot be guilty of manipulation. Actually, there are two questions involved here—was the price which Cargill received for its futures contracts artificially high, and if so, did Cargill cause it?

In order to determine whether the price of the future was artificial, some standards or tests must be used to compare normal prices with the prices alleged to be artificial. The Government proposes four different tests for determining whether the price of the May future was artificial and asserts that Cargill's demanded price fails all of them.

The first three tests proposed by the Government consti-

tute an historical analysis of the May 1963 futures prices in comparison with the prices for the preceding nine years on the Chicago Board of Trade. We find no serious differences between the parties as to these three tests and shall only summarize them here. First, the Government contends that the record 18⅜ cents price rise of the future in the last two days of trading was not comparable to movements in the past nine years, and in fact in six of those years the futures price actually declined. Secondly, the Government contends that the spread between the May and July wheat future in 1963 increased a record 18⅜ cents during the last two trading days, and that no comparable movement occurred during the prior nine years, in seven of those years the spread remaining the same or decreasing. Thirdly, the Government contends that the May 1963 futures price was considerably out of line with the Kansas City futures price as compared with these prior years.

We think that the Government's tests with respect to these movements of the futures price are proper and that the weight of the evidence clearly supports the finding that they were abnormal in 1963. Cargill really makes no substantial attack on these findings, although it does rather belatedly suggest in its reply brief that in fact the May 1963 prices were very similar to the May 1958 prices, and thus there was nothing unusual about them. However, even Cargill's own figures demonstrate substantial discrepancies in the May 1963 movements as compared with the May 1958 movements, its argument ignores the other years, and it also ignores the fact that the Government has pointed out that the Department of Agriculture investigated the May 1958 wheat futures prices and found them to be artificial, but no prosecution followed because it was not determined that they were intentionally brought about.

The fourth test proposed by the Government for determining the artificiality of the futures price is whether it bore a proper relationship to the price of cash wheat in May 1963 and particularly at the close of trading on May 21. Cargill vigorously joins issue with the Government at this point and the parties are in total disagreement as to what the cash value of wheat was at this time.

This is an important element of the Government's case and some more detailed discussion of the mass of conflicting evidence is warranted. In one point, the parties are in apparent agreement. In theory at least the price of the future should be approximately 2½ to 3 cents less than the price of the cash wheat, the discount reflecting warehouse loadout charges; the price of the future may also be depressed somewhat below the cash price because of the uncertainties as to when and what grade of wheat may be delivered.[11] The problem with matching theory to fact lies in the difficulty of determining the cash price of wheat, for actual cash trades on the Chicago spot market are relatively infrequent[12] and the prices of individual transactions may vary greatly depending on the positions of the parties, the quantity involved, and the time of the transaction.

The Government's evidence as to the cash price of wheat can be summarized as follows: First of all, the Government relies on an analytical study by a Department of Agriculture expert which established that the average economic value of No. 2 soft red winter wheat at Chicago during May 1963 was within the range of $2.10 - 2.17. Secondly, it relies on the

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[11] This was established by witnesses for both Cargill and the Government. Testimony of Cargill's witnesses Dr. Gray and Jaffray and the Government's witness Dr. Robinson.

[12] From February 21, 1963 to the closing of the May futures on May 21, 1963 there was only one sale on the spot market.

cash prices of wheat quoted by the Grain Market News, a publication of the Department of Agriculture, which quoted cash prices as substantially below the futures price. Thirdly, it points out that the cash prices as quoted by both the Grain Market News and the Sosland cards, a trade publication, fell rather sharply following the close of trading in the future, and argues that this shows that the cash prices were artificially high due not to basic demand by users but rather by demand from the speculators for delivery on the future.

The Government also points out that the prices received by Cargill for its Spanish sales of $2.13½ and $2.09 per bushel, which sales were made only a few days before the end of trading, were substantially below the prices it ultimately received for its futures, and that the prices Cargill received for its remaining grain after the settlement on the contracts were substantially below those prices. While there were some cash sales made on May 20 and 21 in the price range of $2.28 per bushel, there were many other cash sales made between May 20 and May 31 at substantially lower prices.[13]

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[13]There was very little demand for cash wheat at this time. The new crop would be available the first part of June. Old stocks were being liquidated and there was no need for the old wheat except for a few mills who were short on their grind requirements. The cash price quoted by USDA Grain News:

May 17	2.15½
May 20	2.18½
May 21	2.28
May 22	2.15
May 23	2.11½
May 29	2.03½

Sosland Trade Publication showed quotations:

May 20	2.27½
May 21	2.40
May 22	2.09
May 24	2.11
May 31	2.03½ bid.

An incident which occurred during the settlement of the open contracts following the close of trading also sheds some light on the cash value of wheat at that time, as well as Cargill's opinion of that value. Goodbody and Company was one of the nine commission firms which had customers with outstanding short contracts in the May future at the close of trading and purchased warehouse receipts from Cargill for $2.28¼. After delivering these receipts in satisfaction of the short contracts of its customers, Goodbody discovered that through an error one of its customers was long 10,000 bushels, and an effort was made to sell the receipts in question. They were first offered to Cargill who refused to buy them; Cargill also suggested that "Goodbody try to locate some of the unresolved shorts from the May contract because an outstanding short would pay more to close out his position than Cargill could economically afford to pay." The receipts were then offered to two mills in the area who bid approximately $2.05 per bushel for them. They were finally sold to another commission firm for $2.18 per bushel, which delivered them in satisfaction of short contracts of its customers.

As against the Government's evidence as to the cash price of wheat, Cargill presented the following evidence. First, it relied on Sosland card, a trade publication, quotations of the cash prices of wheat which were higher than the Grain Market News quotations, and contended that this was a more reliable source. Secondly, it relied on testimony of two expert witnesses who maintained that the futures price was not out of line with the cash price. It also relied on the testimony of various trade witnesses who testified generally that they thought the futures price reflected basic supply and demand factors. And it relied heavily on the fact that on May 20 and 21 it had made cash sales of wheat for a price of $2.28. It may be pointed out that even assuming that the

cash value of wheat was $2.28, according to the theory agreed on by Cargill and the Government, the futures price should then be about $2.25 to reflect the loadout charge. Yet Cargill's sell order was in the range of $2.27 - $2.28¼.

The evidence on this particular point is conflicting, but the preponderance is in favor of the Government. The finding that the futures price was artificially high and did not reflect basic supply and demand factors for cash wheat is supported by the weight of the evidence. And in addition the other three tests proposed by the Government very clearly support the ultimate conclusion that the futures price was artificially high.

The question now is whether the artificially high price was caused by Cargill. The Government contends that it was Cargill's withholding of its 2,000,000 bushels of contracts until the last few minutes of trading which caused the dramatic rise in price. Cargill however contends that the price rise simply reflected the traders' judgment that, because of the loadout of the previous weekend for the Spanish sales resulting in the depletion of Chicago supplies, the price of cash wheat would have to rise to meet unfilled mill demand in the area, and that its method of liquidation had nothing whatsoever to do with the price rise.

This would seem to be a case where the market pattern speaks for itself. On Friday, May 17, before the Spanish sales were known to the public, the future closed at $2.09½, a price incidentally very close to that for which Cargill made its last Spanish sale. On Monday, May 20, after the Spanish sales were known, the price of the future advanced 9¾ cents over the previous day's close. This price rise was gradual throughout the day and was probably attributable to the decrease in supplies. On May 21, the future opened slightly higher than the previous day's close and then gradually de-

clined. It eventually reached a low of $2.15¼ at 11:02 and then gradually rose again. At 11:45, the time when Cargill placed its sale order, it was trading at $2.20, which was about 1½ cents over the previous day's close. In other words, throughout the day prior to Cargill's last minute sale the market was resistant to any further increase in the price of the future. Cargill's sell order was at prices 7 and 8 cents over what the future was then selling for, and it was able to get these prices because there was nowhere else for the shorts to go to offset their contracts. It seems clear that the only reason the price advanced so rapidly during the last few minutes of trading was because of Cargill's dominance of the long interest and the high prices it set for liquidation.

Cargill argues that its market behavior was not particularly unusual and that other experienced grain merchandisers analyzed the market conditions similarly to Cargill. It points out for example that Ralston-Purina, Inc. and Central Soya Company, both experienced grain merchandisers, had speculative long positions in the May 1963 wheat future and both liquidated their positions at a profit on the last day of trading. It is interesting to compare the transactions of these companies with those of Cargill.

Cargill established its speculative long position on April 15 at a time when it had substantial uncommitted stocks in its warehouse. It increased those holdings until May 15, when it held 1,930,000 bushels. After selling 40,000 bushels on May 20, it purchased another 100,000 bushels during the early periods of trading on May 21 and then liquidated those holdings during the last fifteen minutes of trading in the very narrow range of $2.27-$2.28⅜.

Ralston established its long position with the purchase of 150,000 bushels on April 30. It did not increase this position during the month of May. It did not establish its specula-

tive long position until after it had sold all its stocks of wheat, so that it did not own any unhedged and uncommitted stocks. Its liquidation on the last day of trading was as follows:

25,000 bushels at $2.18½
50,000 bushels at $2.20¾
25,000 bushels at $2.21½
50,000 bushels at the close of trading at $2.28⅝.

It liquidated in that broad range because it wanted to get an average price for the day and could not be certain of the bottom or the top of the market range.

Central Soya liquidated its short hedges on its uncommitted stocks on May 1. It did not establish its speculative long position until May 16, when it purchased 220,000 bushels. It did not increase that position. 150,000 bushels of its long futures were liquidated on May 20 for an undisclosed price (but obviously one at $2.19 or less since that was the high for that day). The remaining 70,000 bushels were liquidated on May 21 at $2.22.

Mr. Ferguson, a commission broker and witness called by Cargill, testified that he advised his long customers on May 21 to liquidate their contracts a little bit at a time throughout the day in order to get an average for the day. He also testified that, "I would not be inclined to show any broker, just for the sake of his nerves, a 2,000,000 sell order for the last 15 minutes, just for the sake of his nerves."

The above evidence suggests that Cargill's method of liquidation cannot be considered to be ordinary market behavior.

D. *Was the squeeze intentionally caused by Cargill?*

Cargill was no novice in futures trading and knew of market conditions which could cause a squeeze. It possessed a very valuable piece of information unknown to the trade at

large, namely that it owned practically all the wheat available for delivery on the May future. Furthermore, being a large merchandiser in the Chicago area, it was in a particularly advantageous position to take advantage of the potential squeeze in disposing of its supplies as well as being able to take delivery of whatever wheat might be found by the few shorts able to avoid the squeeze in the futures market. Its behavior in liquidating its contracts was clearly intentional and was highly unusual market behavior; and the method of liquidating the unresolved open interest following the close of trading was also unusual and clearly controlled by Cargill.

Aside from the obvious inferences to be drawn from the objective facts in this case, there is other evidence in the record which shows that Cargill knew exactly what was going on. On May 6, an inter-office telegram was sent which stated:

> "Excellent wheat summary. Question is how much wheat going to be available June 15 so we can figure old crop needs and what it going to cost our pals."

In an interview with the Department of Agriculture investigators, a Cargill executive said that the Spanish business came about at a good time because without it, if Cargill had "bulled" the market, there would have been criticism. He also said that the sell order was not placed until the last minute because he "waited and watched because he knew the market was going up." This was knowledge other traders did not have.

Cargill also argues that it fully intended to take delivery of cash wheat if the futures price did not reach at least $2.27 because it felt it could profitably market the wheat at that price. The evidence is otherwise. It is to be remembered that the wheat market at the end of May was in transition from

old crop to new crop. New crop wheat is much cheaper than old crop wheat. Thus both users and merchandisers seek to keep their old crop supplies at the lowest level possible at the end of the crop year in order to be able to take advantage of new crop prices as soon as the new crop is available. It is inconceivable that Cargill would want to take 2,000,000 bushels of old crop wheat to try to merchandise before the new crop came in. In fact Cargill's officers themselves testified that Cargill was liquidating its stocks "to the zero point."

If Cargill believed it could merchandise 2,000,000 bushels of cash wheat at $2.27 it is difficult to understand why just the prior weekend it had sold 600,000 bushels to Spain at $2.09. Furthermore, even after the close of trading in the future Cargill did not take delivery of cash wheat but liquidated the bulk of its remaining open position by selling its own warehouse receipts. And it would not even buy back the 10,000 bushels that had been mistakenly sold to Goodbody.

The extraordinary price fluctuations of the futures market on May 20 and 21, 1963, in the Chicago Board of Trade were the largest in recent history and had very little relationship to basic supply and demand factors on No. 2 soft red winter wheat. None of the other markets was so affected. The cash market in Chicago was to a limited degree cornered due to the depletion of local supplies. This small corner however does not appear to have been manipulated but came about normally from accelerated liquidation of the old wheat crop. There was no appreciable demand for additional cash wheat except for a few mill grind requirements. The long futures holders were not standing for delivery but for the maximum possible price, which Cargill was able to obtain to a substantial degree by bulling the futures market in the last 7 min-

utes of trading and in employing the method of liquidation utilized after the trading closed. Cargill did not sell at the market price but set the market price by reason of its dominant long position in the closing 7 minutes. The cash market quickly adjusted to the demand at the close out of the old crop and prices dropped substantially to where they were prior to the last few days of the futures trading.

The conclusion is well founded that these severe fluctuations were caused by Cargill's manipulative actions and such severe fluctuations constitute a threat to a free and orderly market. It is difficult for us to perceive how Cargill can ignore the fact that its second Spanish sale at $2.09, which was offered on May 15 and confirmed on May 18, is a true indicator of an unmanipulated cash market. This constituted a good economic sale, which we may concede, but it is difficult to view the true cash market at $2.28 a few days later.

The 18⅝ cents rise in the futures price would have to be caused primarily by Cargill's dominance of the long futures market during the closing minutes of trading and its liquidation thereafter of its long futures. The shorts as a practical matter had nowhere else to go except to Cargill and Cargill knew it. The Spanish sales while completely legal did temporarily deplete local supplies and laid the base for a squeeze by the dominant longs. The rise of futures to the maximum permissible of $2.28⅝ was no corrective action to bring futures in line with the cash market, which was substantially lower up to the last day of trading and returned to its previous lows for the month after the squeeze had been effected and the shorts liquidated. It thus appears that Cargill exploited its position in this tight situation, while most of the other longs did not.

We conclude that the squeeze was intentionally brought about and exploited by Cargill.

Cargill also argues that it cannot be found guilty of manipulation because it was relying on *Volkart v. Freeman*, 311 F.2d 52 (5th Cir. 1962), and the advice of its counsel that all its activities were perfectly legal. We cannot agree that reliance on the *Volkart* decision can preclude a finding that Cargill was guilty of manipulation if this court should conclude that *Volkart* was wrongly decided or not determinative in the instant case. In the first place, the *Volkart* decision does not represent a clearly defined line of cases establishing a definitive standard of acceptable conduct under the statute prohibiting manipulation; it is in substantial conflict with both *Great Western Distributors, Inc. v. Brannan*, 201 F.2d 476 (7th Cir. 1953), and *G. H. Miller & Co. v. United States*, 260 F.2d 286 (7th Cir. 1958). Cargill was clearly picking and choosing which precedent it would follow. And the *Volkart* decision has been criticized by commentators.[14] Secondly, Cargill was playing close to the line of even the *Volkart* decision. Both the hearing referee and the Judicial Officer pointed out distinctions between this case and *Volkart*.[15] Finally the Judicial Officer took into consideration Cargill's alleged reliance on *Volkart* and suspended all sanctions. We do not believe anything more is required if we conclude that this manipulation is in fact prohibited by the Commodity Exchange Act. *Compare Simpson v. Union Oil Co.*, 396 U.S. 13 (1969), *reversing* 411 F.2d 897 (9th Cir.).

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[14]See "The Delivery Requirement: an Illusory Bar to Regulation of Manipulation in Commodity Exchanges." 73 Yale Law J. 171 (1963).

[15]For example, Volkart contended that its position was a hedge, not speculative. Furthermore, Volkart did not control a significant amount of the spot commodity and had not contributed to its shortage, whereas Cargill controlled almost all the available cash wheat and was responsible in large part for the existing shortage by its Spanish sales. Finally, the Fifth Circuit found no evidence of intent to manipulate on the part of Volkart.

We turn now to a discussion of the *Volkart* case.

V. THE VOLKART DECISION AND MANIPULATIVE SQUEEZES

Read at its broadest reach, which is the way Cargill reads it, the *Volkart* decision holds that manipulative squeezes are not prohibited by the Commodity Exchange Act. It is somewhat difficult to discern why the Court reached this result, but apparently its concern was that a contrary result would relieve the shorts of their delivery obligation and transform the futures contract into a gambling transaction. We think this approach disregards commercial reality and the economic functions of the futures market.

While the obligation to make or take delivery is a bona fide feature of the futures contract, in reality the futures market is not an alternative spot market for the commodity itself, and indeed the functions performed by the futures market would probably be severely hampered if it were turned into an alternative spot market. For most parties who engage in futures transactions are in no position to either make or take delivery, and if they were required to always make preparations to fulfill their obligations to make or take delivery, the number of persons who could effectively participate in the futures market would be substantially restricted, thus reducing the liquidity and volume of that market. The main economic functions performed by the futures market are the stabilization of commodity prices, the provision of reliable pricing information, and the insurance against loss from price fluctuation. The functions can be fulfilled only if both longs and shorts can be assured that they can offset their contracts at non-manipulated prices. If in a squeeze situation, the shorts must be forced either to pay manipulated prices to offset their contracts or in the alterna-

tive to bring in higher priced outside supplies which are neither wanted or needed in the local market, then both the cash and the futures markets will be dislocated. Cargill's transactions in the liquidation of its futures contracts produced such a dislocation in the futures market in the instant case and we cannot conceive that any useful purpose would be served by encouraging such conduct in the future.

Cargill argues in its brief that this position "leaves the long at the mercy of the shorts in local shortage situations, and * * * will succeed only in eventually destroying futures markets. * * * Further, it is clear that if the long is not permitted to ask what, in his judgment, is a price reflecting the cost of bringing in wheat from outside, the futures market is no longer reflecting the real supply-demand situation, but is artificially low, and the prices are therefore useless to the trade and nation."

The first answer to this argument is that it is difficult to imagine a local shortage situation in which the long is at the mercy of the short. Cargill was certainly not at the mercy of the shorts in May 1963 and would not have been had it even liquidated its holdings in an orderly fashion. And had it so liquidated its holdings, it would still have made a handsome profit on its investment, even without the added increment which its manipulation produced. The second answer is that we have been shown no good reason why the futures price should reflect the cost of bringing in a higher price and grade of wheat for which there is no demand in the local area. It is this price which was artificially high and therefore useless to the trade and nation.

Thus we conclude that if the *Volkart* decision is to be interpreted as prohibiting regulation of manipulative squeezes, it is not in line with the Commodity Exchange Act, 7 U.S.C. § 1 et seq., providing for competitive trading markets and

proscribing excessive speculation, and should not be followed.

PROCEDURAL CLAIM AND OTHER CONTENTIONS

Cargill argues that the instant proceeding is void because there was no advance notice given to it that its conduct was violative of the statute, as required by the Administrative Procedure Act, 5 U.S.C. § 558(c), which provides as follows:

> "* * * Except in cases of willfulness or those in which public health, interest, or safety requires otherwise, the withdrawal, suspension, revocation, or annulment of a license is lawful only if, before the institution of agency proceedings, the licensee has been given—
>
> "(1) notice by the agency in writing of the facts or conduct which may warrant the action; and
>
> "(2) opportunity to demonstrate or achieve compliance with all lawful requirements."

We think it is clear that Cargill's acts were willful within the meaning of the Act and thus the section is not applicable. *See Great Western Distributors, supra*, at 484.

Cargill also contends that the proceedings were void because of the bias and prejudice of the referee and the reviewing Judicial Officer. We find no merit to these contentions.

The order is affirmed.

A true copy.

Attest:

Clerk, U. S. Court of Appeals, Eighth Circuit.

APPENDIX B

STATUTORY PROVISION

TITLE 7 — AGRICULTURE

COMMODITY EXCHANGE ACT AS AMENDED

§ 9.—*Exclusion of persons from privilege of "contract markets"; procedure for exclusion; review by court of appeals.*

If the Secretary of Agriculture has reason to believe that any person (other than a contract market) is manipulating or attempting to manipulate or has manipulated or attempted to manipulate the market price of any commodity, in interstate commerce, or for future delivery on or subject to the rules of any contract market, ... he may serve upon such person a complaint stating his charges in that respect, which complaint shall have attached or shall contain therein a notice of hearing, specifying a day and place not less than three days after the service thereof, requiring such person to show cause why an order should not be made prohibiting him from trading on or subject to the rules of any contract market, and directing that all contract markets refuse all trading privileges to such person, until further notice of the Secretary of Agriculture, and to show cause why the registration of such person, if registered as futures commission merchant, or as floor broker hereunder, should not be suspended or revoked. Said hearing may be held in Washington, District of Columbia, or elsewhere, before the Secretary of Agriculture, or before a referee designated by the Secretary of Agriculture, which referee shall cause all evidence to be reduced to writing and forthwith transmit the same to the Secretary

of Agriculture. Upon evidence received, the Secretary of Agriculture may prohibit such person from trading on or subject to the rules of any contract market and require all contract markets to refuse such person all trading privileges thereon for such period as may be specified in the order, and, if such person is registered as futures commission merchant or as floor broker hereunder, may suspend, for a period not to exceed six months, or revoke, the registration of such person. Notice of such order shall be sent forthwith by registered mail or by certified mail or delivered to the offending person and to the governing boards of said contract markets.

After the issuance of the order by the Secretary of Agriculture, the person against whom it is issued may obtain a review of such order or such other equitable relief as to the court may seem just by filing in the United States court of appeals of the circuit in which the petitioner is doing business a written petition praying that the order of the Secretary of Agriculture be set aside. A copy of such petition shall be forthwith transmitted by the clerk of the court to the Secretary of Agriculture and thereupon the Secretary of Agriculture shall file in the court the record theretofore made, as provided in section 2112 of Title 28. Upon the filing of the petition the court shall have jurisdiction to affirm, to set aside, or modify the order of the Secretary of Agriculture, and the findings of the Secretary of Agriculture as to the facts, if supported by the weight of evidence, shall in like manner be conclusive.

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No. 71-1130

In the Supreme Court of the United States

OCTOBER TERM, 1971

CARGILL, INCORPORATED, ET AL., PETITIONERS

v.

EARL F. BUTZ, SECRETARY OF AGRICULTURE, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENTS IN OPPOSITION

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A, pp. 1–39) is reported at 452 F. 2d 1154. The opinion of the Judicial Officer of the United States Department of Agriculture appears at 29 A.D. 880 (CEA 1970).

JURISDICTION

The judgment of the court of appeals was entered on December 7, 1971. The petition for a writ of certiorari was filed on March 6, 1972. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether the evidence supports the finding of the Secretary of Agriculture that the petitioners manip-

ulated the market price of May 1963 wheat futures, in violation of Section 6(b) of the Commodity Exchange Act (7 U.S.C. 9), by extracting artificial prices in the sale of their futures contracts.

2. Whether "squeezes," intentionally brought about, are a form of manipulation prohibted by Section 6(b) of the Act.

STATEMENT

A hearing examiner of the Department of Agriculture found that petitioners Cargill, Inc., a corporation engaged in the grain merchandising and export business, and four of its officers, had manipulated the price of May 1963 wheat futures on the Chicago Board of Trade on May 21, 1963, and the price of cash wheat in Chicago on May 20 and 21, 1963, in willful violation of Sections 6(b) and 9 of the Commodity Exchange Act (7 U.S.C. 9, 13). He proposed an order suspending the registration of Cargill as a futures commission merchant under the Act for 90 days and an order to the contract markets to refuse all trading privileges to all petitioners for 90 days. Upon a *de novo* review of the record, the Judicial Officer of the Department of Agriculture affirmed the hearing examiner's decision in all material respects, but suspended the proposed sanctions (A. 77).

1. THE COMMODITY EXCHANGE ACT

Commodity exchanges are markets where the right to receive or the right to deliver goods such as grain during a specified future month are bought and sold. When a person buys futures he becomes obligated to take delivery of the commodity or make an offsetting

sale and is referred to as a "long" (Pet. App. A-3). When a person sells futures he becomes obligated to deliver or make an offsetting purchase and is referred to as a "short" (*ibid.*).

As set forth in the Commodity Exchange Act, 7 U.S.C. 1–17b,[1] Congress found that with respect to futures trading in wheat and other designated agricultural commodities, transactions and prices "are susceptible to speculation, manipulation, and control," which frequently give rise to "sudden or unreasonable fluctuations." Since this would be detrimental to producers, consumers and handlers of these commodities,[2] Congress found it necessary to regulate the commodity exchanges.

The Act thus provides that all trading in futures in the specified commodities must be conducted on designated boards of trade regulated by the Secretary of Agriculture. 7 U.S.C. 2, 6. Manipulation or attempted manipulation of the market price of any commodity in interstate commerce or for future delivery on or subject to the rules of any board of trade is a violation of the Act. 7 U.S.C. 9, 13. The Secretary is empowered to issue complaints against persons he believes to have violated the Act and if, after a hearing, a violation is found the Secretary may impose sanctions, including suspension of trading privileges. 7 U.S.C. 6g, 9. The Secretary's order is reviewable in

[1] The Act is derived from the Grain Futures Act of 1922, 42 Stat. 998. See Campbell, *Trading in Futures Under the Commodity Exchange Act*, 26 Geo. Wash. L. Rev. 215 (1958), discussing the background, legislative history and purposes of the Act.

[2] *See Chicago Board of Trade* v. *Olsen*, 262 U.S. 1, 39.

the courts of appeals, but his findings of fact "if supported by the weight of the evidence, shall * * * be conclusive." 7 U.S.C. 9.

2. CARGILL'S TRADING IN MAY 1963 WHEAT FUTURES

Between April 15, 1963, and May 15, 1963, Cargill increased its speculative[*] long position in May 1963 wheat futures from 250,000 bushels to 1,930,000 bushels (Pet. App. 8). In early April, shortly before it began buying these futures, only Cargill knew that it owned nearly 90 per cent of the deliverable wheat stored in Chicago warehouses (Pet. App. 9). By May 20, 1963, Cargill had sold to Spain or otherwise committed all but 50,000 bushels of wheat in its Chicago warehouses, which constituted all of the wheat in Chicago deliverable on May 1963 wheat futures (Pet. App. 9–10).

May 21, 1963, was the last day on which May 1963 wheat futures could be traded on the Chicago Board of Trade and, under the Board's rules, price fluctuations were limited to 10 cents above or below the closing price on the previous day, which was $2.18⅝ per bushel, an increase of 9¾ cents over the closing price of the day before. Acting on Cargill's instructions to sell on an ascending scale of prices, Cargill's broker began liquidating Cargill's holdings on May 21 at

[*] Cargill's position was speculative because it had "ample supplies of uncommitted wheat stocks" and was not buying futures to insure sufficient supplies to meet delivery obligations (Pet. App. 8 n. 4).

11:53 a.m., seven minutes before closing. At this time Cargill had 62 per cent of the open interest in May 1963 wheat futures. By closing time at 12:00 p.m., the price of these futures had reached the maximum of $2.28⅝ and Cargill had managed to liquidate 1,625,000 of the 1,990,000 bushels it held in those futures.[4] (Pet. App. 10–11).

Cargill later sold warehouse receipts at $2.28¼ per bushel, and these were in turn tendered to Cargill in satisfaction of the delivery obligation of the shorts "who were unable to get out of the market in the closing rush" (Pet. App. 13).

3. DECISIONS OF THE HEARING EXAMINER AND JUDICIAL OFFICER

The Secretary's complaint charged Cargill and four of its officers with manipulating the market price of May 1963 wheat futures by means of a "little corner" or "squeeze." A "squeeze" can occur when deliverable supplies of a commodity in the delivery month are low, and the open interest on the futures market is considerably in excess of the deliverable supplies (Pet. App. 15). Then most of the shorts cannot satisfy their contracts by delivery and must therefore bid against

[4] Because of confusion in the pits, Cargill's broker could not execute the remainder of its order, thus leaving Cargill with 365,000 bushels in the May future (Pet. App. 11).

[5] See note 4 *supra*.

each other in order to offset their contracts, thus driving up the price of the future (*ibid.*).[6]

In this case the complaint alleged that "(1) Cargill acquired and held a controlling long position in the May 1963 wheat futures; (2) there was an insufficient supply of wheat available to the shorts for delivery on the futures, and what supply there was was controlled by Cargill; (3) Cargill exacted an artificially high price in liquidation of its futures contracts; and (4) the squeeze was intentionally caused by Cargill" (Pet. App. 15).

Cargill challenged the factual bases of each of the above elements of the complaint, and, in addition, argued that squeezes are not a form of manipulation prohibited by the Act (Pet. App. 16).

The hearing examiner found that the evidence supported the Secretary's complaint on each of the above points, and rejected Cargill's other defenses. Upon a *de novo* review, the Judicial Officer affirmed the findings of the hearing examiner (A. 31–78), concluding that Cargill had acted with manipulative intent, that

[6] A "corner" designates the situation where a trader buys up enough of the commodity in the cash market to dry up the supplies available for delivery and, at the same time, fails to offset his long position during the last days of trading in the futures. See, *e.g.*, *Great Western Food Distributors, Inc.* v. *Brannan*, 201 F. 2d 476 (C.A. 7), certiorari denied, 345 U.S. 997. A "squeeze" differs from a "corner" in that the trader dominates only the futures market by owning long futures contracts considerably in excess of the deliverable amount of the commodity, which may be in low supply for reasons other than the trader's monopoly of the cash market. (Pet. App. 14–15).

[7] "A." refers to the Appendix in the court of appeals.

is, "it intentionally undertook to influence the May futures price and cash price upward" (A. 70).[5]

With respect to Cargill's defense that there were deliverable supplies of wheat available, which the shorts could have delivered on their contracts under the Board of Trade's rule permitting delivery for 7 days after the end of trading, the Judicial Officer found that (A. 72):

> Outside of soft red wheat being utilized by mills in Chicago, there was practically no available deliverable wheat in Chicago except that held by Cargill.
>
> As far as soft red winter wheat outside Chicago is concerned, if there were supplies which could be economically deliverable by the shorts after May 21, it would hardly be necessary for the Chicago Board of Trade to come to Cargill after the end of trading and participate in the arrangement of dubious validity described in Finding of Fact 30 [the delivery and re-delivery of Cargill's own warehouse receipts to the unresolved shorts].

Thus, "there were time and economic impediments to

---

[5] The Judicial Officer summarized his findings on this point as follows (A. 70):

"The next question for consideration is whether Cargill's activities described above were done with manipulative intent, that is, with intent to influence prices upward. Of course Cargill was not long because it wanted delivery of wheat upon its long contracts, or because it was hedging. Its long position was a speculative one and, at the least, it hoped or expected that the May futures price would go up. But we think that the preponderance of the evidence reveals that Cargill was not content merely with hopes and expectations and that it intentionally undertook to influence the May futures price and cash price upward."

the importing of wheat into Chicago by shorts for delivery within the seven days allowed."[9] The shorts instead preferred to pay the illegal premiums charged by Cargill, since this was less risky and less expensive (A. 73).

4. THE COURT OF APPEALS DECISION.

In a comprehensive opinion, the court of appeals affirmed (Pet. App. 1–39). After reviewing the evidence and the findings of the Judicial Officer, the court concluded that the "finding that the futures price was artificially high and did not reflect basic supply and demand factors for cash wheat is supported by the weight of the evidence" (Pet. App. 30).

The court also held that a "squeeze" was a form of manipulation prohibited by the Act. "[T]he test of manipulation must largely be a practical one if the purposes of the Commodity Exchange Act are to be accomplished" and the "aim must be therefore to discover whether conduct has been intentionally engaged in which has resulted in a price which does not reflect basic forces of supply and demand" (Pet. App. 17). Reviewing the legislative history of the Act, the court found that "squeezes were intended to be prohibited where they were intentionally manipulated" (Pet. App. 14).

Cargill argued that squeezes should not be illegal because this would relieve shorts of their obligation

[9] A principal reason for the shortage of available wheat in the Chicago area was that Cargill had been selling abroad substantial quantities of wheat it owned, while building up its long futures position (Pet. App. 9–10).

to deliver. But the court rejected this contention because a futures market is not an alternative spot market and if futures trading is to perform its function of stabilizing commodity prices, both longs and shorts must be "assured that they can offset their contracts at non-manipulated prices" (Pet. App. 37). A squeeze dislocates both the cash and futures markets and it would serve no useful purpose to encourage activity such as Cargill's (Pet. App. 37–38).

ARGUMENT

The decision below is correct, and there is no reason for review by this Court.

1. In large measure, petitioners' contentions are based on disagreement with factual findings of the Judicial Officer. Thus petitioners argue that the Judicial Officer erred in his findings that Cargill had the requisite intent (Pet. 6–9), that other wheat was not available to the "shorts" (Pet. 7), and that the price of wheat futures at the end of trading in May 1963 futures was artificial and did not represent real economic values (Pet. 11). On the basis of its own review of the evidence, the court below properly sustained these findings as supported by the weight of the evidence (Pet. App. 30).

The facts here, as found by the Judicial Officer (A. 67–68), show one of the most obvious forms of manipulation—indeed, one described in the legislative history of the Act as the kind of transaction Congress sought to prevent. See 80 Cong. Rec. 8089. As the court of appeals stated, the "extraordinary price fluctuations of the futures market on May 20 and 21,

1963, in the Chicago Board of Trade were the largest in recent history and had very little relationship to basic supply and demand factors on No. 2 soft red winter wheat. None of the other markets was so affected" (Pet. App. 34). But "the only reason the price advanced so rapidly during the last few minutes of trading was because of Cargill's dominance of the long interest and the high prices it set for liquidation" (Pet. App. 31). As compared with the activity of other experienced grain merchandisers on May 20 and 21, "Cargill's method of liquidation cannot be considered to be ordinary market behavior" (Pet. App. 32). "Its behavior in liquidating its contracts was clearly intentional and was highly unusual market behavior; and the method of liquidating the unresolved open interest following the close of trading was also unusual and clearly controlled by Cargill" (Pet. App. 33).

As the court of appeals stated (Pet. App. 34–35), Cargill did not want delivery and held out only to drive the price up to an artificial peak:

> It is inconceivable that Cargill would want to take 2,000,000 bushels of old crop wheat to try to merchandise before the new crop came in. In fact Cargill's officers themselves testified that Cargill was liquidating its stocks "to the zero point."
>
> * * * * *
>
> The long futures holders were not standing for delivery but for the maximum possible price, which Cargill was able to obtain to a substantial degree by bulling the futures market in the

> last 7 minutes of trading and in employing the method of liquidation utilized after the trading closed. Cargill did not sell at the market price but set the market price by reason of its dominant long position in the closing 7 minutes.
>
> * * * * *
>
> The conclusion is well founded that these severe fluctuations were caused by Cargill's manipulative actions and such severe fluctuations constitute a threat to a free and orderly market. * * *

2. The court of appeals fully answered Cargill's argument that the Secretary's decision leaves the longs at the mercy of the shorts in local shortage situations, and will succeed only in eventually destroying futures markets (Pet. App. 38):

> The first answer to this argument is that it is difficult to imagine a local shortage situation in which the long is at the mercy of the short. Cargill was certainly not at the mercy of the shorts in May 1963 and would not have been had it even liquidated its holdings in an orderly fashion. And had it so liquidated its holdings; it would still have made a handsome profit on its investment, even without the added increment which its manipulation produced. The second answer is that we have been shown no good reason why the futures price should reflect the cost of bringing in a higher price and grade of wheat for which there is no demand in the local area. It is this price which was artificially high and therefore useless to the trade and nation.

As the court also pointed out, "[w]hile the obligation to make or take delivery is a bona fide feature of the futures contract, in reality the futures market is not an alternative spot market for the commodity itself, and indeed the functions performed by the futures market would probably be severely hampered if it were turned into an alternative spot market" (Pet. App. 37). If in a squeeze situation, the shorts are forced either to pay manipulated prices to offset their contracts or to bring in higher priced outside supplies that are neither wanted nor needed in the local market, then both the cash and the futures markets will be dislocated.

The sharp contrast between the activities of others in a long position and those of Cargill further supports the conclusion that Cargill manipulated the market price. While others were liquidating their long positions in an orderly way, Cargill was increasing its long position in order to gain an inordinate advantage over the shorts at the last minute because of the lack of deliverable wheat—a condition to which Cargil had substantially contributed (see n. 9 *supra*.).

The prices Cargill demanded and received for its futures and its warehouse receipts were not sufficiently high to force the shorts to bring in wheat from Kansas City, St. Louis, Fort Worth, or other locations, but this does not itself disprove the artificiality of the prices Cargill established. The fact that outside supplies exist "means that there is merely a ceiling placed on the extent of manipulation possible. The availability of such supplies does not negate the exist-

ence of a manipulation." *In re G. H. Miller & Company, et al.*, 15 A.D. 1015, 1046, affirmed, *G. H. Miller & Company* v. *United States*, 260 F. 2d 286 (C.A. 7), certiorari denied, 359 U.S. 907. See also *In re Great Western Distributors, Inc.*, 10 A.D. 783, 809, affirmed, *Great Western Food Distributors, Inc.* v. *Brannan*, 201 F. 2d 476, 480–481 (C.A. 7), certiorari denied, 345 U.S. 997. The shorts had to choose between paying Cargill's liquidating prices or paying someone else more. They understandably chose the former course. The fact that the latter course was open to them does not show that Cargill's prices were justified. The position in which the shorts found themselves is precisely the situation a manipulator seeks to bring about.

3. Petitioner contends that there is a conflict between the decision below and *Volkart Brothers, Inc.* v. *Freeman*, 311 F. 2d 52 (C.A. 5). As the court below pointed out, however, there are essential differences between the situation here and the situation in *Volkart*:

> For example, Volkart contended that its position was a hedge, not speculative. Furthermore, Volkart did not control a significant amount of the spot commodity and had not contributed to its shortage, whereas Cargill controlled almost all the available cash wheat and was responsible in large part for the existing shortage by its Spanish sales. Finally, the Fifth Circuit found no evidence of intent to manipulate on the part of Volkart.

(Pet. App. 36, n. 15). Furthermore, unlike Volkart, petitioner possessed valuable information unknown

to other traders, namely, that it owned practically all the wheat available for delivery on the May future (Pet. App. 9).

Although *Volkart* held that squeezes "not planned or intentionally brought about" are not prohibited by the Act, 311 F. 2d at 58–59, the court ended its lengthy opinion in that case with the following statement, which petitioners interpret as meaning that even intentional squeezes may not be prohibited: "For the respondents to proceed upon the assumption that the shorts should not be required to deliver at maturity would be to put them in the position of regulating a gambling institution rather than a legitimate futures exchange." *Id.* at 60. But whatever this somewhat oblique passage may suggest about the Fifth Circuit's views on the issue, it is not an actual decision on the point, and does not establish that the Fifth Circuit would have decided the present case contrary to the way the Eighth Circuit did. An approach to the problems of manipulation in the commodities market as unduly restrictive as petitioners propose should not be imputed to the Fifth Circuit, particularly in view of the fact that other courts have rejected such an approach, see *Great Western Food Distributors* v. *Brannan*, 201 F. 2d 476, 481 (C.A. 7), certiorari denied, 345 U.S. 997; *G. H. Miller & Co.* v. *United States*, 260 F. 2d 286, 289 (C.A. 7), certiorari denied, 359 U.S. 907, as did the court of appeals in this case.[10]

[10] See also *Chicago Board of Trade* v. *Olsen*, 262 U.S. 1, 39, where this Court noted that "[m]anipulations of grain futures

The economic unsoundness of immunizing manipulative squeezes from the Act's prohibitions and the reasons why Congress could not have intended such a result are fully set forth in the opinion below (Pet. 37–39). In any event, there is no direct conflict here, and thus no occasion to review this essentially factual case.[11]

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for speculative profit, though not carried to the extent of a corner or complete monopoly, exert a vicious influence and produce abnormal and disturbing temporary fluctuations of prices that are not responsive to the actual supply and demand and discourage not only this justifiable hedging but disturb the normal flow of actual consignments. A futures market lends itself to such manipulation much more readily than a cash market."

[11] There is no merit to petitioners' contention that the court's decision here conflicts with *Board of Trade of the City of Chicago* v. *Christie Grain & Stock Co.*, 198 U.S. 236 (Pet. 10–12). The decision below is fully in accord with this Court's statement there that "[t]he sales in the pits [futures contracts] are not pretended, but, as we have said, are meant and supposed to be binding." 198 U.S. at 249–250. This court also pointed out in that case (198 U.S. at 248):

"* * * The fact that contracts are satisfied * * * by set-off and the payment of differences detracts in no degree from the good faith of the parties, and if the parties know when they make such contracts that they are very likely to have a chance to satisfy them in that way and intend to make use of it, that fact is perfectly consistent with a serious business purpose and an intent that the contract shall mean what it says. * * *"

Christie Grain does not suggest that because shorts have a binding legal obligation, they must anticipate, and have no recourse against, deliberate manipulations that render it more difficult for them to satisfy their legal obligations.

CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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Supreme Court of the United States

OCTOBER TERM, 1971

No. 71—1130

CARGILL, INCORPORATED, ERWIN E. KELM, H. ROBERT DIERCKS, WALTER B. SAUNDERS and BENJAMIN S. JAFFRAY,

Petitioners,

vs.

CLIFFORD M. HARDIN, Secretary of Agriculture, THOMAS J. FLAVIN, Judicial Officer by Appointment of the Secretary of Agriculture, and the UNITED STATES DEPARTMENT OF AGRICULTURE,

Respondents.

BRIEF OF BOARD OF TRADE OF THE CITY OF CHICAGO AS AMICUS CURIAE IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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Preliminary Statement

A petition for writ of certiorari to the United States Court of Appeals for the Eighth Circuit was filed on March 6, 1972 by Cargill, Incorporated and certain of its officers (collectively "Cargill"). They seek review and reversal of the decision in *Cargill, Inc. et al.* v. *Clifford M. Hardin et al.*, Appeal No. 20,597 (8th Cir., December 7, 1971), in which the Court of Appeals found that Cargill had manipulated the price of May 1963 wheat futures contracts in violation of § 6(b) of the Commodity Exchange Act as amended [7 U.S.C. § 9].

The Board of Trade of the City of Chicago (hereafter "Board of Trade"), with the prior written consent of all parties below, has entered its appearance as *amicus curiae* to urge that the petition of Cargill be granted and to submit, at a later date, a brief on the merits urging rejection of certain erroneous legal principles fashioned by the Court of Appeals in reaching its decision below.

The Board of Trade urges that the petition of Cargill be granted for each of the following reasons:

1. The decision of the Court of Appeals is in direct conflict with the decision of the Court of Appeals for the Fifth Circuit in *Volkart Bros., Inc.* v. *Freeman*, 311 F.2d 52 (5th Cir. 1962), dealing with the same issues of law and having analogous facts. This conflict is repeatedly recognized by the Court of Appeals in its decision below.

2. The decision of the Court of Appeals is in conflict with the rulings of the United States Supreme Court in *Board of Trade of the City of Chicago* v. *Christie Grain & Stock Co.*, 198 U.S. 236 (1905).

3. The decision of the Court of Appeals is in conflict with applicable state laws governing the legality of commodity futures trading.

4. The decision of the Court of Appeals concerns an important question of federal law—the definition of "manipulation of prices" in commodities futures trading—which has not been, but should be, settled by the United States Supreme Court.

Nature and Interest of Board of Trade

The Board of Trade is the world's largest marketplace for buying and selling commodity futures contracts. In 1971, over 8.5 million "futures contracts" in wheat, corn, oats, soybeans, soybean oil, soybean meal, silver, plywood,

iced broilers (dressed chickens) and choice steers were traded on the floor of the Board of Trade. The estimated dollar value of the commodities involved in the trading exceeded Eighty-eight Billion Dollars ($88,000,000,000).

The Board of Trade was founded in 1848 and has operated since 1922 as a "contract market" under the Commodity Exchange Act and its precursor, the Grain Futures Act [7 U.S.C. §§ 1-17b]. Under the Commodity Exchange Act, the Secretary of Agriculture has authorized the Board of Trade to provide a futures market for a variety of agricultural products including wheat, the subject of the pending action. In order to obtain such authorization from the Secretary, the Board of Trade has been required to fulfill certain conditions set forth in the Act. For purposes of this case, the principal statutory condition is that the Board of Trade must "provide for the prevention of manipulation of prices and the cornering of any commodity by the dealers or operators upon such board." [7 U.S.C. § 7(d).] Failure by the Board of Trade to comply continually with this anti-manipulation condition can result in the suspension or revocation of the Secretary's authorization to conduct a futures market in regulated commodities. [7 U.S.C. § 7b.] In the absence of the Secretary's authorization, it would be unlawful for the Board of Trade to operate a futures market in regulated commodities. [7 U.S.C. § 6.]

According to publications of the Commodity Exchange Authority, the agency within the Department of Agriculture engaged in administration of the Commodity Exchange Act, the Board of Trade is only one of twenty (20) futures markets in the United States which are subject to the Act. All such markets have the same commitment as the Board of Trade to "provide for the prevention of manipulation of prices and the cornering the any commodity. . . ." [7

U.S.C. § 7(d).] During 1971, futures trading on all such "contract markets", including the Board of Trade, exceeded a dollar value of One Hundred Twenty-five Billion Dollars ($125,000,000,000).

Each of the twenty futures markets supervised under the Act has a direct and vital interest in resolution of the present conflict among the Courts of Appeals. Each futures market is required by the Act to formulate surveillance procedures, record-keeping requirements, and organization staff adequate to meet its statutory responsibility to "provide for the prevention of manipulation." In 1971, the Board of Trade alone spent over $500,000 in its surveillance programs. In addition, hundreds of voluntary man-hours are spent each year by members of the Board of Trade on committees dealing with screening, surveillance, and compliance. Similar compliance structures, aimed in large measure toward providing for the prevention of manipulation and other wrongdoing, exist on other commodity exchanges as well. The effective operation of these surveillance programs cannot be carried out so long as the test of "manipulation" under the Act remains the subject of debate among the Courts of Appeals.

The Legal Issues

I.

The Court of Appeals Has Rendered A Decision In Conflict With The Decision Of Another Court Of Appeals On The Same Matter.

The decision of the Court of Appeals is in direct conflict with the decision of the Court of Appeals for the Fifth Circuit in *Volkart Bros., Inc.* v. *Freeman*, 311 F.2d 52 (5th Cir. 1962), dealing with the same issues of law and having analogous facts. This conflict is repeatedly recognized by the Court of Appeals in its decision below.

The Court of Appeals' acknowledged disagreement with the *Volkart* case is fundamental. The holding in the *Volkart* case is careful to distinguish between natural squeezes (a supply shortage caused by ordinary market forces) and manipulative squeezes (a shortage engineered by market participants). *Volkart* soundly criticizes the latter but recognizes that the former may exist and that persons astute enough to anticipate and profit by them should not be punished as manipulators. (311 F.2d at 59.) On the other hand, the Court of Appeals in the instant case holds that a squeeze can be a manipulation when there is "a shortage of deliverable supplies *for whatever reason*" and the "long" acquires contracts in excess of those "deliverable supplies" (Petition, p. A-15, emphasis supplied.)[1]

In the body of its opinion in the instant case, the Court of Appeals for the Eighth Circuit discusses the holding in *Volkart* and asserts "The Fifth Circuit reached this conclusion without any economic analysis whatsoever and did not discuss its apparent discrepancy with the *Great Western*[2] case." (Petition, p. A-23.) Later in that same paragraph the Court, in reference to part of the *Volkart* decision, states "[W]e do not consider it to be economically realistic." (Petition, p. A-23.)

So complete is its rejection of the *Volkart* case that the Court of Appeals devotes an entire section of its opinion

[1] Citations to "Petition" refer to the Petition for a Writ of Certiorari filed in this case by Cargill *et al.* on March 6, 1972.

[2] *Great Western Food Distributors, Inc.* v. *Brannan*, 201 F.2d 476 (7th Cir. 1953); *cert denied*, 345 U.S. 997 (1953). Comparing *Volkart* and *Great Western*, the Court of Appeals noted a second conflict among the Circuits when it stated that "the two cases available appear to have split on the question." (Petition, p. A-22.) Indeed, the Court of Appeals held that *Volkart* "is in substantial conflict with . . . *Great Western*" and with another decision of the Seventh Circuit (Petition, p. A-36). Thus, not two but *three* Circuits, the Fifth, Seventh, and Eighth, are involved in the present debate over the legal meaning of "manipulation".

(Part V) to a discussion of what it considers to be the inadequacies of the *Volkart* case. As part of that discussion the Court of Appeals castigates the *Volkart* holding in the following terms:

> It is somewhat difficult to discern why the Court reached this result, but apparently its concern was that a contrary result would relieve the shorts of their delivery obligation and transform the futures contract into a gambling transaction. We think this approach disregards commercial reality and the economic functions of the futures market. (Petition, p. A-37.)

This open and apparent difference of opinion between the respective Courts of Appeals should be settled by the United States Supreme Court.

II.

The Court of Appeals Has Decided a Federal Question Contrary To the Decision of the United States Supreme Court.

No principle is more firmly fixed in the law of commodity futures trading than that the delivery obligation inherent in such contracts is legally binding upon the parties.

In the first decade of this century, commodity futures trading was repeatedly attacked under state "bucket shop" laws on the ground that the delivery obligation in futures contracts was merely "pretended" and not binding. In *Board of Trade of the City of Chicago* v. *Christie Grain & Stock Co.*, 198 U.S. 236 (1905), the Supreme Court laid this issue to rest as to Board of Trade futures contracts by concluding that the delivery obligation on such contracts is legally binding and, upon maturity, the "short" must be prepared to deliver and the "long" must be prepared to receive and pay for that delivery. As Justice Holmes stated:

> There is no doubt, from the rules of the Board of Trade or the evidence, that the contracts made between the members are intended and supposed to be binding in manner and form as they are made. (198 U.S. at 248-49).

But the Court of Appeals below has ruled flatly against the sanctity of the delivery obligation. This ruling involves three interrelated features:

> *First,* the lower court ruled that "shorts", faced with a natural shortage of the local commodity, need not acquire the commodity elsewhere nor deliver a better grade of commodity from local sources if additional cost to them would result. In effect, the Court of Appeals sanctioned economic disadvantage as a lawful excuse for failure to deliver.
>
> *Second,* the lower court ruled that "shorts" are entitled to be released from their futures contracts at a noncompetitive price lower than they would have paid in making delivery from outside sources or in delivering a better grade of the commodity, and that "longs" who demand and receive a price reflecting the cost of delivery risk charges of manipulation.
>
> *Third,* the lower court aimed a broadside at the very concept of delivery, concluding repeatedly that it is an undesirable, disruptive and distorting influence upon prices in the cash market when local supplies are scarce. The Court of Appeals' decision would limit the delivery obligation, at best, to situations where there is an abundant, cheap local supply of wheat or, in cases of supply shortage, to satisfying a current local need for the commodity among cash merchants and processors. Absent such abundance or a demonstrable "need" among local merchants, however, the lower court would permit "shorts" to ignore their delivery obligation, and thereafter to settle with the "longs" at bargain prices.

The opinion of the Court of Appeals relieved the "shorts" of their delivery obligation by constraining the "available supply" of wheat (i.e., what the "shorts" must be prepared to deliver) to soft red winter wheat located in Chicago as of the last day of futures trading. This, notwithstanding that another grade of wheat was acknowledged by the Court to be available which could have been delivered by the "shorts":

> [I]t appears that there were ample supplies of hard wheat in surrounding areas which could have been shipped to Chicago in time for delivery on the future. *** (Petition, p. A-21).

The lower court decided to exclude these "ample supplies" simply because of the additional cost to the "shorts":

> Hard wheat was of a higher grade than No. 2 soft red winter wheat, its price was higher, no premium was allowed for its delivery, and the cost of shipment into Chicago for delivery on the future was an additional economic impediment to its delivery. *** (Petition, p. A-22).

The Court of Appeals then stated that it was more economical for the "shorts" to offset in the futures market with the "longs," even at a premium:

> It would be more economic to pay the long a premium than to pay the additional charges for premium [hard] wheat plus shipping and handling charges. (Petition, p. A-22).

Even though this was "more economic", the lower court refused to place even this responsibility on the "shorts". Instead, the Court of Appeals held that the "shorts" need pay to the "longs" only a price reflecting "historical" norms (Petition, pp. A-25 and A-26), or a price equal to the elusive[3] current "cash price" in Chicago at the time (Petition, p. A-27). And, because the prices paid by these "shorts" to Cargill exceeded the largely theorized "historical" and highly conjectural "current" cash prices, the Court of Appeals concluded that the price was "artificial" and manipulative.

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[3] The lower court readily acknowledged the elusiveness of these cash prices: "The problem with matching theory to fact lies in the difficulty of determining the cash price of wheat, for actual cash trades on the Chicago spot market are relatively infrequent and the prices of individual transactions may vary greatly depending on the positions of the parties, the quantity involved, and the time of the transaction." (Petition, p. A-27).

The lower court's ruling, whereby in local shortage situations the "longs" must somehow confine their bids to "historical" or "current" price ranges, collides not only with the basic nature of the commodity markets as vigorous auction forums, but also presents an irreconcilable conflict with the open and unfettered competition mandated by the Commodity Exchange Act. The Secretary of Agriculture, pursuant to his rulemaking power under the Act, has insisted that "all purchases and sales of any commodity for future delivery . . . shall be executed openly and competitively by open outcry . . . or by other equally open and competitive methods . . . ." [Reg. § 1.38, 17 C.F.R. § 1.38]. Now, in a tacit reversal of that philosophy, the Secretary has successfully urged the Court of Appeals to prohibit vigorous competition between "longs" and "shorts" when a local shortage of the commodity exists. Settle out, says the Court of Appeals, at a price below what competition would produce; otherwise, face the risk of being charged as a "manipulator."

The lower court's methodical emasculation of the delivery obligation, first by excluding from "available supply" all sources involving additional cost to the "shorts" and, second by requiring "longs" to settle with the "shorts" at less than a competitive price, reflects that Court's basic sentiment that delivery on futures contracts during local scarcity is undesirable and should be discouraged.

The Court of Appeals' opinion is laced with criticism of the delivery obligation as such. The lower court clearly inferred that delivery in local shortage situations, if ever justified, should be limited to satisfying a local need among cash merchandisers and processors for the commodity. The Court of Appeals bluntly ruled that delivery for other purposes (such as honoring the obligations of the futures contract) produces a "dislocation" of prices:

> While the obligation to make or take delivery is a bona fide feature of the futures contract, in reality the futures market is not an alternative spot market for the commodity itself .... For most parties who engage in futures transactions are in no position to either make or take delivery, and if they were required to always make preparations to fulfill their obligations to make or take delivery, the number of persons who could effectively participate in the futures market would be substantially restricted, thus reducing the liquidity and volume of that market. The main economic functions performed by the futures market are the stabilization of commodity prices, the provision of reliable pricing information, and the insurance against loss from price fluctuation. The functions can be fulfilled only if both longs and shorts can be assured that they can *offset* their contracts at non-manipulated prices. If in a squeeze situation, the shorts must be forced either to pay manipulated prices to offset their contracts or in the alternative to bring in higher priced outside supplies which are neither wanted or needed in the local market, then both the cash and the futures markets will be dislocated.*** (Petitions, pp. A-37 and A-38, emphasis added.)

And, in response to Cargill's argument that the price received by it on offset merely reflected the costs that "shorts" would have incurred if they had fulfilled their delivery obligation, the Court of Appeals held that such a price is nevertheless "artificial" whenever the local cash market would not need the commodity if it were delivered:

> [W]e have been shown no good reason why the futures price should reflect the cost of bringing in a higher price and grade of wheat for which there is no demand in the local area. It is this price which was artificially high and therefore useless to the trade and nation. (Petition, p. A-38).

The foregoing analysis by the Court of Appeals reflects two unprecedented assumptions:

> *First*, that the demand for cash wheat resulting from the delivery obligation in futures contracts is

not a legitimate demand and should be ignored in determining the extent of local "need" for cash wheat.

Second, that neither delivery nor a futures price reflecting delivery costs is legally justified unless there is a current local "need" (excluding the needs of "shorts") for the cash wheat.

The sentiment of the Court of Appeals that delivery upon futures contracts is a distorting influence upon cash prices in cases of local scarcity, and that the delivery obligation generates demand for cash wheat which is not a legitimate part of the supply-demand equation, attacks the very core of futures trading by cutting it adrift from the cash market. Maintaining a relationship with the cash market is indispensable to the utility of the futures market as a pricing mechanism and as a hedging medium. The Court of Appeals, by its ruling, has gravely threatened that relationship and, in the process, endangers the economic functions of a futures market.

III.

The Court of Appeals Has Decided An Important State Question In A Way In Apparent Conflict With Applicable State Law.

The decision of the Court of Appeals is in conflict with applicable state laws governing the legality of commodity futures trading. Under the doctrine announced by the United States Supreme Court in *Dickson* v. *Uhlman Grain Co.*, 288 U.S. 188 (1933), any dilution of the delivery obligation may render a commodity futures contract subject to challenge under state gaming laws which prohibit futures trading where delivery is not contemplated. The ruling of the Court of Appeals relieves sellers from their delivery obligation under such recurring circumstances of natural supply shortages that state gaming laws may become applicable to prohibit heretofore lawful futures trading.

The Illinois statute against gambling by means of pretended contracts for future delivery of commodities is illustrative of such state statutes. The Illinois statute provides in pertinent part as follows:

> (a) A person commits gambling when he: . . .
>
> (4) Contracts to have or give himself or another the option to buy or sell, or contracts to buy or sell, at a future time, any grain or other commodity whatsoever, or any stock or security of any company, where it is at the time of making such contract intended by both parties thereto that the contract to buy or sell, or the option, whenever exercised, or the contract resulting therefrom, shall be settled, not by the receipt or delivery of such property, but by the payment only of differences in prices thereof: . . . (38 Ill. Rev. Stat. § 28-1.)

In the *Uhlman Grain* case referred to above, the broker represented to the customer that he would not have to make or take delivery of commodities pursuant to trades executed by the broker for the customer's account on the Board of Trade. The Supreme Court found that the broker's oral representation that his customer would not have to make or take delivery relieved the customer of his contract obligation and thus rendered the trades gambling contracts and void.

The Court of Appeals in the instant case has relieved the "shorts" of their delivery obligation whenever there is a "shortage of deliverable supplies for *whatever reason*." (Petition, p. A-15 emphasis supplied.) The Court of Appeals reasons that in a local shortage, if the delivery obligation were enforced, "shorts" would have to bring the commodity in from some distant source of supply, or to deliver a better grade of the same commodity. The added cost is an economic disadvantage and, under the reasoning of the Court of Appeals, is thus a lawful excuse for non-

performance of the delivery obligation. If the "shorts" no longer have an obligation to deliver when they face an economic disadvantage to do so, then the contracts for future delivery and payment may be subject to unwarranted attack under state gambling statutes similar to the Illinois statute quoted above.

IV.

The Court of Appeals Has Decided An Important Question Of Federal Law Which Has Not Been, But Should Be, Decided By The United States Supreme Court.

The decision of the Court of Appeals concerns an important question of federal law—the definition of "manipulation of prices" in commodities futures trading—which has not been, but should be, settled by the United States Supreme Court. "Manipulation of market prices" is proscribed by the Commodity Exchange Act (7 U.S.C. § 9) but neither the Act nor the Regulations thereunder contains a definition of that important term. The self-regulatory system envisioned by the Commodity Exchange Act dictates that the term "manipulation of market prices" have a definition readily discernable to the exchanges and their members.

The Supreme Court has not yet resolved this critical question. Although the Court has considered the definition of "manipulation of prices" in the contexts of securities markets, antitrust enforcement and other commercial regulation, the commodity futures markets introduce new and different factors bearing upon the legal issue. Thus, as in the present case, it is necessary to fashion a legal definition of "available supply" of the commodity in order to determine whether the legally requisite "squeeze" is present. This requires consideration of unique factors such as transportation, handling and storage costs of the commodity,

whether varying grades are commercially interchangeable, whether ungraded supplies should be included and myriad other unique factors of agricultural marketing not confronted in securities or antitrust cases. Moreover, there is the balancing of the open competition mandated by the Commodity Exchange Act and the resultant benefits to the consumer, with the prevention of engineered price squeezes.

As if inviting review by the Supreme Court, the Court of Appeals noted that "There are no Supreme Court precedents on this question under the Commodity Exchange Act" (Petition, p. A-24), and remarked that "Case authority under the Commodity Exchange Act which would aid in the determination of this question is meager indeed, and the two cases available appear to have split on the question." (Petition, p. A-22.) The present proceeding offers a rare opportunity for the United States Supreme Court to remedy this void, which has thus far generated only debate and conflict.

The lower courts, the contract markets, and all participants in futures trading will benefit from a review of the decision below. We respectfully urge that Cargill's petition for a writ of certiorari be granted.

Respectfully submitted,

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